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IN THE

Supreme Court of the United States

OCTOBER TERM, 1945.

No. 1220

PHILLIPS, et al., *Petitioners*,

v.

THE BALTIMORE AND OHIO RAILROAD COMPANY, *Respondent*.

IN THE MATTER OF

THE BALTIMORE AND OHIO RAILROAD COMPANY, *Petitioner*.

In Proceedings for a Railroad Adjustment under Chapter
XV of the Fankruptey Act.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MARYLAND.

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**PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES DISTRICT COURT FOR THE
DISTRICT OF MARYLAND.**

*To the Honorable the Justices of the Supreme Court of the
United States:*

Your petitioners are Amy, Darius and Randolph Phillips, owners of \$100,000 principal amount of the Convertible 4½% bonds due 1960 of the Baltimore & Ohio Railroad Company.¹

¹ Randolph Phillips is also attorney in fact for the owners of approximately \$1,800,000 principal amount of these Convertible bonds. However, when proof of this representation was offered at the time of the hearing on the decree it was excluded on the ground that the record had already been closed.

Petitioners respectfully pray that a writ of certiorari issue to review the decree of the specially constituted three-judge United States District Court for the District of Maryland entered in this cause on March 13, 1946, approving and confirming a plan of adjustment for the B. & O. under Chapter XV of the Bankruptcy Act.

OPINIONS BELOW.

The report and order (T. 11)¹ of the Interstate Commerce Commission (hereinafter called the I. C. C.) under Section 20a of the Interstate Commerce Act, authorizing the issuance and modification of the respective securities as proposed by the adjustment plan involved herein, are reported in 261 I. C. C. 51; its report and order (PX. 4, p. 97) authorizing the participation by the Reconstruction Finance Corporation (hereinafter called the R. F. C.) in said plan are reported in 261 I. C. C. 211. The opinion (T. 1549) of the special three judge District Court (Circuit Judges Soper² and DcÖie and District Judge Chestnut) approving and confirming the plan is reported in 63 F. Supp. 542.

JURISDICTION.

The decree of the District Court was entered March 13, 1946. (T. 1936). A motion for a new trial was filed by petitioner Randolph Phillips on March 23, 1946 (T. 1990) and denied on March 27, 1946. (T. 2005). The jurisdiction of this Court is invoked under Section 745 of Chapter XV of the Bankruptcy Act, (11 U. S. C. § 1245).

¹ Petitioners have moved the Court to dispense with the printing of the record for the purpose of considering this petition. References are therefore to the unprinted transcript, pages being preceded by the letter T. — and exhibits referred to as OX (present petitioner's exhibits) and PX (B. & O. exhibits) plus a page number.

² Judge Soper was substituted for Circuit Judge Parker after the initial hearings in July but before the September hearings. No party in interest objected.

QUESTIONS PRESENTED.

1. Did the court err in finding that the plan involved herein is fair and equitable as an adjustment and as such will (a) afford due recognition of the rights of each class of creditors and stockholders and fair consideration to each class adversely affected and (b) will conform to the law of the land regarding the participation of the various classes of creditors and stockholders?
2. Did the court err in holding that the jurisdictional requirement that the petition be filed in "good faith" meant merely that there must not be "intentional fraud",³ and did it err in making the findings of good faith required by Sections 714 and 725(5) of Chapter XV?
3. Did the court err in finding that the Company was "unable to meet its debts matured or about to mature", as those terms are used in Sections 710 and 714 of Chapter XV?
4. Did the court err in finding that the jurisdictional percentages of bondholders of each class had assented to and accepted the plan in view of (a) the absence of evidence that the authorizations assenting to the plan were executed by or on behalf of persons who held the bonds at the time of filing and approval of the plan and (b) unfair solicitation practices, in particular the misrepresentation as to the obligation of the bonds in the solicitation literature?
5. Did the court err in finding that the Company had satisfied the requirements of law and that the plan should be approved?

³"But in this case the phrase, lack of 'good faith' is used in its primary sense of intentional fraud". In the Matter of the Baltimore & Ohio Railroad Company, 63 F. Supp. 542, at 557, fn. 16.

STATUTE INVOLVED.

Chapter XV of the Bankruptcy Act, commonly referred to as the McLaughlin Act, was approved October 16, 1942. It is substantially identical with the previous enactment of Chapter XV which was effective from July 28, 1939, to July 31, 1940. Chapter XV is an alternative to Section 77 of the Bankruptcy Act. It is designed for railroads in temporary financial difficulty and provides a procedure for the adjustment of debts of railroads not in equity receivership or under Section 77 reorganization.

The procedure under Chapter XV may be briefly described as follows: The Company prepares a plan and receives "assurances of acceptance" from creditors holding at least 25 per cent of the aggregate amount of all claims affected. It then obtains an order from the I. C. C. authorizing the issuance or modification of the securities as proposed by the plan. The I. C. C. is required to make limited findings relating generally to the feasibility of the plan and the public interest. Section 710(2) (11 U. S. C. Sec. 1210 (2)). The I. C. C. is not required to make the crucial findings that the company is "unable to meet its debts matured or about to mature"⁴ or that "the plan is fair and equitable as an adjustment and as such will (a) afford due recognition to the rights of each class of creditors and stockholders and fair consideration to each class adversely affected and (b) will conform to the law of the land regarding the participation of the various classes of creditors and stockholders".⁵ These findings are required to be made only by the court. Section 725 (3) 11 U. S. C. Sec. 1225 (3).

⁴ The opinion of the I. C. C. (T. 15) clearly shows that it did not make a finding of inability to pay debts (see T. 64). Nor did the District Court rely on any such purported finding of the I. C. C. See also note 6, *infra*.

⁵ The I. C. C.'s view that it has no responsibility with respect to the issue of what is fair and equitable under Chapter XV is set forth in *Delaware & Hudson Railroad*, 254 I. C. C. at pp. 240-241, as follows:

After obtaining an order from the I. C. C. and assents to the plan from two-thirds of the aggregate amount of the claims affected and from at least a majority of each class thereof, the Company files, for approval of the plan by a special three-judge court, a petition which must aver that the Company is unable to meet its debts matured or about to mature. Section 710(3), 11 U. S. C. Sec. 1210(3). The court is not permitted to appoint a receiver or trustee or to control the Company's operations. Section 715 (11 U. S. C. Sec. 1215).

The court is expressly required to scrutinize the facts independently of any findings by the I. C. C. If it makes the requisite findings, it enters an order approving the plan. Among these findings are (a) the "*Boyd* case" finding quoted above; (b) a finding that the plan and its acceptance are in good faith; (c) a finding that the requisite acceptances have in fact been obtained; and (d) a finding that the provisions for management are adequate and fair. Section 725, last paragraph (11 U. S. C. Sec. 1225).⁶

"It will be observed that while certain of these specific findings are the same as or similar to those which we must make in approving a plan of reorganization under Section 77 of the Bankruptcy Act, others definitely negative any concept that our functions in a proceeding such as this are as broad as those under a Section 77 proceeding in which we must find among other things that the plan conforms to the principles of" . . . [the *Boyd* case]. "This is also clearly shown by the legislative history of Chapter XV. For instance in the report for the House Committee on the Judiciary, adopted by the Senate Committee on Interstate Commerce, accompanying H. R. 7121, which became Chapter XV, it is stated: 'The public interest in the proceeding is protected by the finding of the Commission, after hearing, that the issuance or modification of securities as proposed conform to Section 20a. The private rights of creditors and stockholders are protected in the proceeding conducted by the three-judge court, and by its findings are required by Section 725 of the bill'."

⁶ The findings required of both the I. C. C. and the court are as follows: (a) That the corporation is not in need of Section 77 reorganization; (b) That its inability to meet its debts is reason-

It should be noted that the solicitation of assents to the plan under Chapter XV is done by the management which also conducts the poll. By contrast, in Section 77 proceedings, solicitation is subject to the supervision of the I. C. C. (§ 77p) which itself conducts the poll and certifies the results to the Court (§ 77e).

The provisions of Chapter XV have expired except in respect of proceedings initiated before November 1, 1945, but legislation to extend its provisions has passed the House of Representatives and is pending in the Senate of the United States.⁷

STATEMENT.

The B. & O. railroad operates more than 6,000 miles of road. The aggregate par and stated value of its capitalization, including subsidiaries, exceeds one billion dollars. Its interest-bearing obligations are between five hundred and six hundred million dollars (including leasehold obligations). Approximately \$500,000,000 of these obligations

ably expected to be temporary only; and (c) That in the light of probable prospective earnings, the plan (i) is in the public interest and in the best interests of each class of creditor and stockholder, (ii) is feasible, financially advisable, and not likely to be followed by insolvency or reorganization or further adjustment, (iii) provides fixed charges which can be adequately covered by probable earnings, (iv) leaves adequate means for future financing and (v) is consistent with adequate maintenance of property and proper performance of the railroad's obligations to the public as a common carrier.

⁷ A somewhat different bill (S. 1253, 79th Cong. 2d Sess.) which "adopts the basic principle of the Chapter XV procedure in authorizing reorganizations without forfeiture of either bonds or stock" (S. Rep. No. 1170, 79th Cong. 2d Sess., p. 145) was reported favorably to the Senate. S. 1253 is designed to supersede the "outmoded and condemned" Section 77 procedure (S. Rep. No. 1170, *supra*, at p. 11) and would remove from Section 77 and place under the new procedure—basically similar to Chapter XV—pending 77 proceedings of certain major railroads including the Denver and Rio Grande, The New Haven, and Missouri Pacific among others.

are affected by the Plan, and are held by some 80,000 owners of whom only 39,000 are listed by the Company as assenting to the plan (PX. 101, p. 2261).⁸ In addition, the Company has outstanding more than \$256,000,000 par value of common stock and more than \$58,000,000 par value of preferred stock.

This is the second time within a period of six years that the railroad has sought relief under the provisions of Chapter XV and its predecessor statute. We shall set forth briefly the facts concerning earlier proceedings as well as the present ones.

The 1939 Plan.

Less than six years prior to the filing of the present petition, an adjustment plan for the B. & O. under Chapter XV of the Bankruptcy Act was approved.⁹ 29 F. Supp. 608.¹⁰ The chief characteristic of the 1939 plan was an eight year moratorium for the payment of interest charges on certain of the railroad's bond issues, including the Convertibles of 1960 which are further affected by the instant plan. In neither the 1939 plan nor the present plan were the contractual rights of the preferred or common stockholders altered, nor were their assents to the plan solicited.

⁸ This would indicate that there are 41,000 non-assenting security holders. The court suggests that some of these may be in Europe and difficult of access, but there were only \$17,000,000 of these securities held in Europe, as of 1939. (29 F. Supp. 608, at 617), and the court in the present proceeding found "no definite evidence" regarding the number of bondholders in the armed services. 63 F. Supp. 542, at 569.

⁹ The period between proceedings is so short that it would have barred a discharge to an ordinary bankrupt. (Sec. 14 (e) 5 of the Act, 11 U. S. C. Section 32 (e) 5).

¹⁰ Certiorari denied *Getz v. B. & O. R. Co.*, 309 U. S. 654; rehearing denied, 309 U. S. 697. Although some attempt was made by the petitioner in that case to raise the *Boyd* case issue, in opposition the B. & O. took the position that this issue was not in fact raised and that the only question before the court on certiorari would be the separate classification of assented and unassented bonds. See p. 7 of B. & O. Brief in opposition No. 625, 1939 Term.

The 1939 plan provided for extending until August 1, 1944, and November 8, 1944, obligations amounting to approximately \$122,000,000, of which \$85,000,000 was due to the Reconstruction Finance Corporation for loans previously made and maturing in 1939-1942. These loans were secured by a large amount of collateral.

In seeking approval of the 1938 plan, the Company represented and the court found that the inability of the B. & O. to meet its debts was reasonably expected to be temporary only, and that, on the basis of prospective earnings, the plan would not be likely to be followed by need of further financial reorganization or adjustment, that it did not provide for fixed charges in excess of probable earnings, and that it would leave adequate means for future financing. The court further found that the 1944 maturities could be met. Its opinion states that they could be refunded "through an anticipated increase in earnings with a consequent increase in market value of the securities . . . constituting the collateral pledged for the loans" (p. 545 of 63 F. Supp.).

In its order approving the 1939 plan, the court below enjoined the B. & O., the RFC and all others from taking action by the institution of judicial proceedings "or otherwise in any way without limitation" inconsistent with the provisions of the plan. Nevertheless, before the expiration of the eight year period of the 1939 plan, without applying for or seeking a modification of the injunction, the Company instituted these proceedings by petition filed on December 4, 1944 with the I. C. C.

The Period Between Plans.

In the years from 1940 through the first eight months of 1945 (PX. 1, p. 29, PX. 88, p. 2011) petitioner's aggregate net profits after payment of all taxes and fixed and accrued contingent charges totaled approximately \$116,000,000.¹¹

¹¹ See note 12, *infra*.

The four years 1941-1944, inclusive, represent the most profitable period in the Company's entire history.¹²

Nevertheless, the Company upon filing the present proceedings represented that it was unable to meet obligations to the RFC maturing in 1944 in the amount of \$81,000,000. It should be noted that during the period between the approval of the first Chapter XV plan and the present plan, (1) the collateral securing the \$81,000,000 debt to the RFC increased in market or appraised value from \$70,000,000 to a total of \$162,000,000 as of December 26, 1944; (2) net working capital increased from a deficiency of \$13,000,000 as of July 31, 1939 to a favorable balance of approximately \$70,000,000 as of December 31, 1945; (3) the cash and cash assets as of December 31, 1945, exceeded \$83,000,000 compared with only \$8,000,000 as of July 31, 1939; (4) in 1943 and 1944—before the RFC loans became due—the Company with the prior knowledge and approval of the Federal Loan Administrator used some \$31,500,000 in sinking fund and other moneys for the retirement of bonds maturing in the years 1948, 1950, 1951, 1957, 1959, 1990, 1995 and 2000, instead of applying the funds to reduction of the RFC loans; (5) accruals for depreciation of equipment and amortization of equipment and road properties from 1940 to 1944, inclusive, totaled more than \$64,000,000.

The Present Proceedings.

On December 4, 1944, a petition as provided by Chapter XV was filed with the I. C. C. as the first step in securing approval of the present plan. The I. C. C. made the necessary findings in an order dated March 12, 1945 and authorized the issuance of securities to consummate the adjustment plan. Petition for approval of the plan was filed in the District Court on July 2, 1945.

The plan provides in substance for the extension of the maturity of the major bond issues of the B. & O. system

¹² The equity of the stockholders was further increased by the retirement of approximately \$100,000,000 of principal amount of system debt at a cost of about \$68,000,000.

aggregating \$495,799,164, the conversion of these bond issues, in whole or in part, from fixed interest to interest contingent as to payment upon earnings and the modification of the indentures securing these bonds to permit the creation of additional prior lien debt. In substance, the RFC debt was extended for twenty years, the first mortgage debt extended for twenty-five years, and the unsecured obligations extended for fifty years.¹³ The second lien

¹³ The following table, copied from the lower court's opinion shows the extension dates and interest treatment of the securities affected by the plan:

Description	Principal amt. Outstanding	Adjustment proposed in plan
Secured notes, matured Aug. 1, 1944, and November 8, 1944	\$82,393,114*	Extended to 1965 by refunding
First Mortgage, 4% Bonds, due July 1, 1948	76,922,350	Extended to July 1, 1975
First Mortgage, 5% Bonds, due July 1, 1948	67,826,500	Extended to July 1, 1975, 1% unsecured interest to be contingent but cumulative
Southwestern Division Bonds, due July 1, 1950	37,285,500	Extended to July 1, 1980, 1½% unsecured interest to be contingent but cumulative
Pittsburgh, Lake Erie & West Virginia Bonds, due Nov. 1, 1951	36,798,000	Extended to Nov. 1, 1980
Toledo-Cincinnati Division 4% Bonds, Series A due July 1, 1959	10,028,700	Extended to July 1, 1985
Refunding and General Mortgage Bonds:		
Series A, 5%, due December 1, 1995	48,989,000	After 1946 interest on A. D. & F. to be 2% fixed and 3% secured contingent; and C to be 2-2/5% fixed and 3-3/5% secured contingent
Series C, 6%, due December 1, 1995	29,218,500	
Series D, 5%, due March 1, 2000	22,390,000	
Series F, 5%, due March 1, 1996	22,041,500	
	122,639,000	
Thirty year 4½% Convertible Bonds, due February 1, 1960	61,906,000	Extended to Feb. 1, 2010, 4½% unsecured interest to be contingent but cumulative
	\$495,799,164	

* Reduced to \$81,600,000, as of May 28, 1945, by collections on collateral (PX. 4, p. 98.)

bonds (Refunding and General Mortgage Bonds) whose maturity dates before the plan were between 1995 and 2000 were not extended but a portion of their fixed interest was made contingent.

The most drastic alteration was in the Convertible Bonds represented by your petitioner. These are extended for fifty years, so that they become due in the Twenty-first Century, *i.e.* 2010, and the entire interest on the bonds for that whole period is made contingent on an annual basis instead of fixed and payable semi-annually. Unpaid interest is made cumulative. In addition, a Capital Fund and a First Sinking Fund are placed ahead of the Convertibles as a charge on earnings. Further, the protection which the Convertible bonds had in the form of a covenant that no new mortgage might be created without ratably securing the Convertibles has been rendered nugatory with respect to additional bonds for new financing permitted by the plan. Plan Art. 5, Sec. 5.

The plan makes no alteration of the contractual rights of preferred and common stockholders. Indeed, no vote of the stock interests on the plan has even been sought.

A statutory three-judge court was convened and hearings were held in July and September, 1945. Your petitioner, Randolph Phillips, appeared below and introduced evidence to show among other things that the plan was unfair and inequitable, in violation of "the law of the land" as reflected by decisions of this Court; that the Company's petition was not filed in good faith; that the Company could not support the allegation that it was unable to meet its obligation to the RFC; that the assents to the plan were obtained pursuant to the misrepresentation that interest on certain of the bonds (including the Convertible) was then contingent; and that the large and unprecedented volume of trading which had taken place in the affected securities invalidated the assents obtained prior to the hearings on the plan in the absence of proof that such securities were still held by those who had executed the

consents. On the issue of good faith, your petitioner in addition to evidence of exceptionally good financial condition of the Company (*supra*, pp. 8-10) introduced testimony showing that the collusive character of the proceeding was so flagrant as to lead to the resignation of the Company's General Solicitor, Cassius M. Clay, and its Special Counsel, Colonel Henry W. Anderson (See *infra*, pp. 24-26).

The statutory court on November 20, 1945 handed down its opinion approving the plan in the form submitted by the B. & O. It ruled that the plan was fair and equitable, that the petition was filed in good faith, that the B. & O. was unable to meet its debts matured or about to mature and rejected all suggestions for amendment except that it modified the plan to provide that one member of the Board of Directors shall be elected by the stockholders "to represent" the Convertible Bonds "if a reasonably suitable nomination is made therefor by the Trustee" for the Convertible issue.¹⁴ 63 F. Supp. 542 at 568. The decree was entered on March 13, 1946. A petition for rehearing was filed by Randolph Phillips on March 23 and denied on March 27. Your petitioners are asking a review of the orders of the District Court.

REASONS FOR GRANTING THE WRIT.

I.

In deciding that the plan submitted by the Company "is fair and equitable as an adjustment" and will "afford due recognition to the rights of each class of creditors and stockholders and fair consideration to each class adversely affected," and "will conform to the law of the land regarding the participation of the various classes of creditors and

¹⁴ The Convertible bondholders, of course, have no voice in the selection of the Trustee or director, and trustees under indentures cannot be relied upon to be truly representative of bondholders. See Report of Securities and Exchange Commission on Protective and Reorganization Committees, Part VI, pp. 71-109.

stockholders" (Section 725, Clause 3),¹⁵ the District Court has decided the instant case in sharp conflict with the applicable decisions of this Court, and in conflict with the decisions of other three-judge federal district courts under Chapter XV. This Court has not reviewed any reorganization under Chapter XV, and it is essential, we submit, that it declare the applicable principles and standards to be applied under that Chapter and related legislation.

There can be no question that the Congress intended by use of the language quoted above to make applicable the doctrine of the *Boyd* case. *Northern Pacific Ry. Co. v. Boyd*, 228 U. S. 482; see also, *Case v. Los Angeles Lumber Products Company*, 308 U. S. 106; *Ecker v. Western Pacific R. Corp.*, 318 U. S. 448; *Group of Institutional Investors v. Chicago, Milwaukee R. Co.*, 318 U. S. 523; *Otis & Company v. Securities and Exchange Commission*, 323 U. S. 624. This is clear from the committee reports in both the Senate and the House (S. Rep. 498, 76th Cong., 1st Sess., (1939); H. R. Rep. 2177, 77th Cong. 2d Sess. (1942); S. Rep. 1617, 77th Cong., 2d Sess. (1942)). The Senate report on the present bill reprints the House Report, including the following language:

"It is not contemplated that any plan of adjustment can be approved by the court for railroad companies where the continued participation of stockholders in the company can be maintained only at the sacrifice of substantive rights of creditors. The bill provides that the plan must conform to the requirements of the law of the land with reference to the participation of stockholders and creditors, and this provision has been interpreted to require that the plan must conform to the principles of *Northern Pacific Ry. Co. v. Boyd* (228 U. S. 482)."

¹⁵ It will be recalled that the ICC does not pass upon the fairness of the plan under Chapter XV in light of the principle of the *Boyd* case. (See *Delaware & Hudson Ry. Corp., Debt Adjustment*, 254 ICC at pp. 240-1, quoted *supra*, note 5.)

Other district courts have found applicable and have applied the *Boyd* case tests. See e.g. *Delaware & Hudson Ry. Corp v. Dancey*, 51 F. Supp. 763, 765 (SDNY 1943).

Although the attention of the court below was called at length to the requirements of the *Boyd* case and cases which reiterate and apply its doctrine, the court did not cite or refer to a single precedent, and in clear departure from them it approved a plan which provides for issuing inferior securities to bondholders without compensation for the sacrifices in the quality of their securities. In the case of the Convertible bonds of 1960, represented by your petitioners, the plan (a) extends their maturity for fifty years or until the year 2010, thereby making them the last of the Company's bonds to mature by postponing their maturity beyond the maturities of the Refunding and General Mortgage (2d lien) Bonds, and destroying their strategic position; (b) converts their fixed interest to contingent interest—not merely for the remaining 15 years of the original life of the bonds, but for the full extended period of 65 years; (c) changes protective features of its Convertible and other bond indentures so as to permit the issuance of large amounts of additional bonds which will be prior to the Convertibles; (d) creates a capital fund and a first sinking fund payment which increase the claims on the earnings prior to the claim of the Convertibles for contingent interest, which funds have the effect of improving the position of stockholders without proportionate benefit to the Convertibles;¹⁶ (e) The provision for the payment of inter-

¹⁶ The Capital fund created by the plan is to be used for additions and betterments. The First Sinking Fund payment is to be used to retire senior debt. It *may not* be used to purchase or retire Convertible Bonds. It is obvious that the earnings diverted from the Convertibles to the Capital fund are of primary benefit to the stockholders whose position is dependent upon the long-range operations of the Company, and not to the bondholders who are comparatively short-term creditors. As to the first sinking fund payment, although it is to the interest of the Convertibles to have senior debt retired, it requires no argument to show that the diversion to this purpose of earnings which, absent the plan, would be avail-

est on the Convertibles postpones the payment of such interest, even if earned, until at least May 1 of the year after it has been earned. None of the interest due the Convertibles is paid during this period of deferment which is at least nine to fifteen months. The effect of this is a compulsory loan, interest free, by the Convertibles to the Company and the stockholders.¹⁷ (f) The plan completely deprives the Convertible bondholders of the fortification of their position provided by the Company's present huge accumulation of cash. Without the plan, interest would be paid on the bonds currently when due even when not earned out of this large reserve. Under the plan when interest is not earned the bondholders must await a period—which may be many years—until it is earned. None of the present reserve or any future reserve earned in years prior to an interest deferment will be available to the Convertible bondholders.

able for the Convertibles, deprives the Convertibles of a valuable right to the direct payment of such earnings to them.

The second sinking fund payments are a charge upon earnings after the payment of fixed charges, capital fund and contingent interest. These payments are to be used to retire, by purchase or call, senior bonds, and a part *may* be used to retire a limited amount of Convertibles; and not in excess of 50 per cent of the fund may be used to create and maintain net working capital and for capital investments.

The third sinking fund payments consist of amounts equal to dividends paid, but these sinking fund payments are to be discontinued when System charges for interest and guaranteed dividends (on rentals) fall below \$20,000,000 annually. These now amount to about \$26,000,000. These payments are usable for the same purposes as the second sinking fund payments.

It is obvious that none of these provides a real cushion for the Convertibles. Indeed, it should be noted that there is no provision whatever for obligatory retirement of Convertibles out of any of the funds, despite the fact that the 1st sinking fund payments are senior to interest payments on the Convertibles. Thus the so-called dividend "restrictions" may evaporate, in effect, while the sacrifices made by the Convertibles remain permanent until the year 2010.

¹⁷ The provision for contingent interest on a yearly basis may result in earnings earlier in the year during what was formerly a semi-annual interest period being wiped out as a result of losses during later operations in the same year.

For these sacrifices, the Convertibles received no compensation. The preferred and common stocks of the Company were not altered in any way. Certain restrictions were placed on the management's dividend policies (discussed *infra* pp. 18-19) but the management was unaffected except as noted above.¹⁸ No cash payment was made to the Convertibles; no stock or rights were given to them; no sinking fund was set up for the mandatory retirement of the Convertibles; and no control of management is given them when interest is unearned.

The reasoning of the Court below is reflected in the following quotation from its opinion:

"The plan does not reduce the principal amount of the capital debt or the obligation of the Railroad for the full interest contracted for thereon, nor does it impair any of the present security for the several affected issues respectively. It merely *postpones* the maturities of the obligations for the principal and possibly some of the interest thereon. With respect to the latter it does not release the railroad from its absolute obligation eventually to pay all that has been contracted for although some portion of the original contract rates is made contingent as to time of payment, dependent upon the sufficiency of current net income . . ." (63 F. Supp. at 551, 552) (Italics in original)

But the court ignored the fact that the substitution of a contingent return for a fixed return and the extension of maturity is a loss of rights of value for which full compensatory provision must be made. See *Consolidated Rock Products Co. v. DuBois*, 312 U. S. 510, 527, 528, where this court stated:

"But the bondholders have not been made whole. They have received an inferior grade of securities, inferior in the sense that the interest rate has been reduced, a contingent return has been substituted for a fixed one, the maturities have been in part extended and in part eliminated by the substitution of preferred

¹⁸ See page 12, *supra*.

stock, and their former strategic position has been weakened. Those lost rights are of value. Full compensatory provision must be made for the entire bundle of rights which the creditors surrender."

The fact that in the present case the interest is cumulative does not alter the case. The Convertible bondholders are by their contract entitled to fixed, semi-annual interest payments. If we assume that under the cumulative feature of the plan, all of the contingent interest will ultimately be paid in the year 2010 or earlier, nevertheless the following points should be noted:

(1) As shown above, *supra* p. 15, the Convertibles are completely deprived until the year 2010 of access to the cushion of earnings represented by the huge reserve funds of the Company. No compensation is made for this loss.

(2) Even if the interest is ultimately paid by reason of its being cumulative, each deferment of a payment represents an involuntary loan of money, interest-free, by the Convertibles to the stockholders. No provision is made for compensation for the unpaid interest. This practice may continue over a period of 65 years—until 2010.

(3) At the very least, the plan destroys the strategic position of the Convertibles. See *Consolidated Rock Products Co. v. DuBois*, 312 U. S. 510, 527, 528. The loss of the right to fixed interest involves surrender of all control over their investment until 2010, the date of maturity. For fixed interest gives a right to institute proceedings for the protection of the investment, whereas contingent interest gives no such right. Accordingly, under the plan the Convertibles may have to stand by, powerless until 2010, witnessing the dissipation of the assets of the Company to their damage.

Indeed, the contingent interest provisions provide even less protection than is usual for preferred stocks approved by the I. C. C. and S. E. C., which provide for substantial representation in management in good years and control

of management in the event of default in dividends for a specific period. See e.g. *St. Louis, San Francisco R. Co.*, 257 I. C. C. 399; *El Paso Electric Co.*, 8 S. E. C. 366, 370, 371.

In contrast, the position of the stock is improved by the creation of a capital fund and sinking funds which may be used for the retirement of debt through tenders or open market purchases. In Chapter XV proceeding for other railroads hitherto decided by the District Courts, the plans require that the sinking funds be used to retire the specific bond issue whose interest or maturity date is changed. Only in the case of the B&O is there no such mandatory requirement, as in the treatment of the Convertibles. And it must be noted that contingent interest provisions without adequate safeguards for bondholder control on non-payment invite the accrual of unwarranted reserves to conceal the existence of actual earnings and to improve the equity position.

Some mention is made by the court of dividend restrictions imposed by the plan but these merely limit the management's discretion in the interest of conservative operation of the Company. In effect, they amount to restrictions upon the management's allocation and use of net earnings. They do not take from the stockholders any of their contract rights, but merely specify the manner in which available net earnings shall be used to improve the equity position by application to specified purposes.¹⁹ Without any plan it is assumed that management would be prudent enough to allocate the necessary funds for capital and sinking fund purposes. The unique character of the present

¹⁹ The plan provides an elaborate scheme for the application of net income. The requirements for all sinking fund payments may fall as low as \$2,500,000. The only dividend restriction in the plan is a temporary requirement that an amount equal to dividends paid shall be paid into the sinking fund to be used for additions and betterments as well as debt retirement. These payments need not be made when charges for interest and guaranteed dividends (on stocks of leased lines) fall below \$20,000,000 annually. Such charges are now about \$26,000,000.

plan is that it takes valuable rights from bondholders in return solely for actions which are normal incidents of competent management. The preferred stock is still entitled to its 4 per cent, undiminished; and the common stock is still entitled to undiminished control²⁹ and to full, undiminished dividends after provision for interest and charges. None of the rights or equities of either class of stock is given to or shared with the Convertibles as compensation for their sacrifices. Thus although the bonds are derogated to the position of a preferred stock, they are nevertheless not endowed with any of the advantages implicit in preferred or common stocks. They must share all the risks of stocks but none of the profits.

As for the sinking fund, its benefit to the Convertible bonds is uncertain at best. Not one cent of the first sinking fund payment (Paragraph 2, Article III of the Plan) is *permitted* to be used to retire Convertible bonds; and not one cent of any of the other sinking funds is *required* to be used for that purpose. Because there is an existing equity value in the stock, these funds, like the Capital Fund, serve in effect merely to enhance that equity.

The Court below conceded (p. 561 of 63 F. Supp.) that the bonds had made "concessions, or, if you please, sacrifices." No argument is made that any concessions of substance are made by the stockholders. And indeed the advantages to stockholders are so clear and the lack of concessions by them so obvious that no vote of stockholders on the plan was deemed necessary.

Some resort is had in justification of the court's treatment of the Convertibles to "realistic conceptions of railroad financing." (P. 562 of 63 F. Supp.)

Thus it is argued that since actual foreclosure of a railroad is an impossibility and since actual payment of inter-

²⁹ See page 12 and footnote 14, *supra*.

est is dependent upon earnings there is in substance no difference between fixed interest and contingent interest and that likewise there is in substance no difference between a debenture and a preferred stock.²¹ But this argument proves too much. It ignores the value of fixed interest claims, of early maturities and of priority over equity interests, whether the company remains solvent or undergoes further reorganization. Indeed, if adopted, this argument would destroy the rule of the *Boyd* case and make stock interests alone invulnerable in reorganization. Logically, the inability to insist on fixed interest payments finds a parallel in the impossibility of foreclosure on property used in railroad operations. Under such an argument, the first, the second and third mortgage on railroad property would be no better than unsecured debt and neither the date of maturity, near or far, nor the character of the interest requirement, fixed or contingent, would be relevant. Indeed, since debt claims could be altered without altering stock interest in a reorganization a first mortgage bond would be a much less desirable security than a preferred or a common stock. In short, the argument that date of maturity and fixed or contingent character of interest are of no consequence is valid only if contracts are meaningless and the courts are free to do as the court below did and ignore the doctrine of the *Boyd* case.

Nor is there anything in Chapter XV which requires alteration of the standards of the *Boyd* case. In *Delaware and Hudson Railroad Corporation v. Dancey*, 51 F. Supp. 763 (S. D. N. Y. 1943), the District Court for the Southern District of New York approved a plan in 1943 by which

²¹ The views of Commissioner Mahaffie of the ICC cited to support this view (See n. 23, p. 562 of 63 F. Supp.) have no relevance to the thesis for which they are cited. The fact that a regulatory agency may regard it as undesirable to burden an enterprise with fixed obligations does not mean that, once created, such fixed obligations should be treated as though they were not fixed.

the Delaware and Hudson was enabled to survive a crisis in its affairs. Only one mortgage was involved and its life was extended for only twenty years while in all other respects it was left undisturbed. Even so, the plan provided that the company make a ten percent cash payment of matured principal and increase the security by the deposit of additional collateral under the mortgage. It also provided a stiff sinking fund arrangement to assure retirement of the bonds, restricted dividends to one-sixth of net income and further provided that the company should use part of the proceeds of the sale of certain securities in further debt reduction. The court also held that because these securities had increased in value since the date of the ICC's action on the Company's application all proceeds in excess of \$5,000,000 as well as the half of the first \$5,000,000 of such proceeds, should likewise be used for debt retirement. See also *Group of Institutional Investors v. Chicago, Milwaukee, etc.*, 318 U. S. 523.

Under the B. & O. plan the Convertible bonds, although they retain the designation "bonds," are, to all intents and purposes, derogated to little more than the position of a preferred stock. Like a preferred stock, they have no maturity date, for certainly extension into the first decade of the 21st century is for all practical purposes an obliteration of their maturity date. Like a preferred stock also, they receive no annual payments unless earned. Their security in both earnings and assets is diluted. Their relative priority in maturity prior to the Refundings is abolished. Their absolute priority in earnings to charges for sinking and capital fund purposes is wiped out. Their absolute priority to enforce payment of unearned interest currently and of their principal in 1960 out of the stock equity is totally eliminated. By the principles of fairness and equity, they must receive full compensation for this treatment, and the present plan gives no such compensation.

The Company has also argued that the Convertible bond-holders "receive 'fair consideration' in what is offered

them through the Plan by other classes of creditors of superior right." The concessions by issues senior to the Convertibles are irrelevant to the question here being presented since it is clear that the Convertible bondholders are receiving less than the equitable equivalent of what they surrender while the equity interests remain untouched. But the "fair consideration" cited by the Company as moving from the stockholders does not meet the test of the rule of strict priorities as enunciated by the decisions of this Court. The only features of the plan to which the management specifically refers—the capital and sinking funds and the dividend provisions discussed above, are in the category which this Court dismissed in the *Milwaukee* case, 318 U. S. 523, 567 by saying that they are merely "incident to a normal and proper operation of the road."

To permit the present plan to stand would mark a substantial erosion of the fixed principle of the *Boyd* case. It would serve as a precedent for reorganizations under Chapter X and Section 77 of the Bankruptcy Act and under Section 11 (e) of the Public Utility Holding Company Act of 1935. There can be no doubt that if the Baltimore & Ohio plan is permitted to stand the courts will be faced with many others, patterned upon it. Instead of continuing or reinforcing the traditional principles of fairness and equity insisted upon by the precedents of this Court, such plans will represent ingeniously contrived escapes therefrom.

II.

In deciding that the petition in the instant case was filed in good faith, the court decided the question in conflict with the decisions of this Court and by the use of an erroneous standard. The court below approved the petition in the present case on the assumption that lack of good faith could be established only by a showing of "intentional fraud." (fn. 16 at p. 557 of 63 F. Supp.) The court concedes that its ruling is in conflict with the broader construction given the same phrase in other statutes such as Chap-

ter X of the Bankruptcy Act, but gives no reason for a narrower construction under Chapter XV.

The court's view turns an affirmative requirement of the statute that the petition be filed in good faith into a nullity except in cases where an objector can carry the burden of showing "intentional fraud". Such a construction sanctions the collusive management plan under the device known in earlier days as the "friendly receivership", and repeatedly outlawed by decisions of this Court. See e.g. *Harkin v. Brundage*, 276 U. S. 36, 54, 55; *National Surety Co. v. Coriell*, 289 U. S. 426. In the instant case the court has blindly followed the guidance of management and violated the injunction of this Court, in the *Coriell* case, *supra*, that "Every important determination by the court in receivership proceedings calls for an informed independent judgment" (at p. 436).

In *First Nat. Bank v. Flershem*, 290 U. S. 504, this Court, through Brandeis, J., strongly condemned a similar device. In that case, despite the allegations of the company that it could not satisfy overdue interest charges without jeopardy to its ability to continue in business (p. 512) and despite the findings of the court below, this Court held that "The substantive law affords no warrant for so abridging the rights of individual creditors" (p. 518). It was held that the purpose and effect of the reorganization was "to hinder and delay certain creditors." (p. 518). And Mr. Justice Brandeis said that this was "fraudulent in law" (p. 518) even though the company sought to justify resort to the courts on the grounds that the reorganization would benefit bondholders as well as stockholders (p. 517).

A brief review of the circumstances of the filing of the present plan will demonstrate that it, just as the proceedings in the *Flershem* case, requires judicial condemnation as a deliberate endeavor of the Company, in violation of the "good faith" requirements of equity and Chapter XV, to use the judicial process to hinder and delay creditors.

It will first be recalled that only a few years before the inception of these proceedings, the Company had received

approval of another "adjustment" plan under Chapter XV, the Company representing and the Court finding that its inability to meet its debts was temporary only; that it would not be likely to be followed by need of further adjustment; that it did not provide for fixed charges in excess of probable earnings, and that it would leave adequate means for future financing. The court further found that the 1944 maturities could be refunded "through an anticipated increase in earnings with a consequent increase in market value of the securities . . . constituting the collateral pledged for the loans." 63 F. Supp. at 545.

It will also be recalled that the actual earnings subsequent to the plan were enormously higher than any that could have been anticipated (*supra*, pp. 8-10), and that the market value of the securities constituting the collateral for the loans maturing in 1944 actually doubled in value in the years between the plans, until its value as of December 26, 1944 was approximately twice the amount of the RFC debt.

Nevertheless, the record shows that as early as 1942—two years before the present proceedings were brought—the Company's management was already considering a re-adjustment under the provisions of enabling legislation which they anticipated that the Congress would provide. (T. 344-347, 836-838). This legislation took the form of a reenactment of Chapter XV, approved on October 16, 1942. The Company then proceeded, without regard to the statute's requirement of "good faith," to bring about an apparent inability to meet debts to the RFC, maturing in 1944, in the face of its excellent financial condition, without precedent in the Company's history. (*Supra*, pp. 8-10).

The facts showed so clearly that the "crisis" in the Company's affairs was entirely synthetic and that it was precipitated by the management's desire to manipulate the position of the bondholders, that two of the Company's chief counsel resigned in protest. On September 15, 1945, two days before the September hearings on the plan, Cassius M. Clay, General Solicitor of the B. & O., and counsel

for the RFC in the 1939 proceeding, submitted his resignation to the B. & O. stating that the present proceeding was "unsound both from a legal and a moral point of view," and that he was unwilling to accept any responsibility for it. When called as a witness in the proceedings below, Mr. Clay, upon cross-examination, characterized the initiation of the proceeding as a "frame-up" and stated that he did not think "an honest effort was made to meet the maturity in any way" (T. 1206; OX 20, p. 3419).²²

Six days after B. & O. announced the promulgation of its second reorganization plan Colonel Henry W. Anderson, of Richmond, Virginia, Chief Counsel for B. & O. in the 1939 proceedings, asked to have a monthly retainer which he was receiving from the B. & O. terminated (PX 112, p. 2882). In a letter to Governor Cornwell, General Counsel, Mr. Anderson wrote "It was stated (in 1939) in effect by the management that if the plan was approved and put into effect . . . that the RFC loan or so much thereof as was not retired in the meantime, could readily be renewed or extended at maturity. This fact found further support in the known policy of the RFC never to use obligations of railroads to force them into bankruptcy. The Court predicated its approval of these provisions of the plan upon these assurances (See opinion October 9, 1939, pages 37-38).

"The expectations of the management as to the results of the operation of the (1939) plan and the improvement in the position of the company have been more than realized . . . I am constrained to feel that my continuance as counsel

²² Attention is directed particularly to the extensive memoranda covering the events of the two years prior to the September, 1945, hearings which were prepared by Clay and received in evidence in support of his oral testimony. (OX 20, pp. 3429-3471)

for the company in these circumstances could not fail to cause me embarrassment." (PX 112 pp. 2284-6)²³

Neither of these eminent attorneys, intimately familiar with the prior plan and the Company's affairs, was willing to be associated with a proceeding which lacked the basic ingredients of good faith. But the court below was willing to accept the unjustified disregard of its order in the 1939 proceedings, and misled by its view that "good faith" was established unless an objector showed "intentional fraud," refused to reject the petition. By adopting and applying this definition of "good faith" it has reopened the door to management manipulation and the destruction of the rights of creditors which characterized the unsavory era of friendly receiverships. This it has done despite the rulings of this Court in cases some of which are cited above, and despite the obvious adoption of the rule of those cases by the Congress in the "good faith" requirements of Chapter XV.

A brief enumeration of facts of record will show in more detail why Mr. Clay and Colonel Anderson refused to be associated with the proceeding or with the management that had the temerity to initiate it:

1. The earnings of the war years between plans were phenomenal. From 1940 through the first eight months of 1945, the Company's aggregate net profits after payment of

²³ On May 5, 1944, John Foster Dulles of Sullivan & Cromwell on May 5, 1944, sent to Snodgrass a preliminary draft of the opinion of his firm, with respect to questions raised by the B. & O. In his opinion Dulles stated that the attitude of the RFC lay "at the foundation of the necessary allegation" that the company was unable to meet its debts and that he assumed that the B. & O. "would have ascertained and honestly believed" that the RFC would not extend its loan except on the conditions outlined in the Henderson letter of April 6, 1944. Upon receipt of a copy of the Dulles opinion, John J. Cornwell, a director and the general counsel of B. & O., read the opinion and made the following notation thereon in ink: "Mr. Clay: Read with interest. Finis! J.J.C." (OX 20, pp. 3419, 3446)

all taxes and fixed and accrued contingent charges totalled approximately \$116,000,000.²⁴ The four years 1941-1944, inclusive, represent the most profitable period in the Company's entire history.

2. During this period the collateral securing the debt to the RFC of roughly \$81,000,000 increased in market or appraised value from \$70,000,000 to a total of \$162,000,000 as of December 26, 1944. At the time of the court's opinion it conceded the collateral a value of \$172,000,000 (p. 560 of 63 F. Supp.).

3. During the same period net working capital increased from a *deficiency* of \$13,000,000 as of July 31, 1939 to a favorable balance of approximately \$68,000,000 as of December 31, 1945 (T. 1892; OX 2 (March), pp. 3505-6).

4. The cash and cash assets as of December 31, 1945, exceeded \$83,000,000 compared with only \$8,000,000, as of July 31, 1939 (*Id.*).

5. In 1943 and 1944—the year before the RFC loans became due—the Company with the prior knowledge and approval of Hon. Jesse H. Jones, the Federal Loan Administrator used some \$31,500,000 in sinking fund and other moneys for the retirement of bonds maturing in the years 1948, 1950, 1951, 1957, 1959, 1990, 1995 and 2000, instead of applying the funds to reduction of the RFC loans. (T. 237, 240, 1292-3; PX 92, 93, pp. 2240-1.)

6. Accruals for depreciation of equipment and amortization of equipment and road properties from 1940 to 1944, inclusive, totaled more than \$64,000,000. (PX 42-47, pp. 1582-1727.)

7. In 1944 the B. & O. paid off in cash \$23,000,000 of its publicly held obligations maturing in that year, without paying any part of its debt of the same issue to the RFC. (OX 4, p. 3401.)

²⁴ See note 12, *supra*. (PX 1, p. 29; PX 88, p. 2011.)

8. The Company obtained a letter from the RFC, dated April 6, 1944, stating that it would extend the debt if modifications were made in other securities similar to those proposed in the present plan. But the facts show that the Company never sought in good faith to secure an extension from the RFC but instead bent every effort to securing as strong a paper record of refusal from the RFC as possible for the sole purpose of supporting a Chapter XV proceeding. For example the RFC was never asked whether it would extend the loan if a substantial payment on account was made. (OX 20, pp. 3428a-3470.)

The facts are in all material respects uncontested. The RFC has never in its history foreclosed a railroad pledge or forced a railroad reorganization by refusing to extend a loan. The facts prove beyond doubt that in the instant case it was merely a willing partner of the management, acting particularly through Stewart McDonald, Chairman of the Executive Committee of the B. & O. and one time Deputy Federal Loan Administrator, and R. L. Snodgrass, Vice President of the B. & O. in charge of Finance, and former Assistant General Counsel of the RFC.

Despite the statement of the lower court that it has independently reviewed all the evidence in accordance with the requirements of the Act, its opinion, as well as the record in this case, indicate that the court was so influenced by the volume of assents to the plan and by rising market quotations since it was first announced,²⁵ as to raise a serious question whether it adequately fulfilled the statutory requirement of scrutinizing the facts "independently of the extent of acceptances of such plan and of any lack of op-

²⁵ The entire bond market, as shown by the Dow-Jones averages, rose to new highs in the period in question (PX. 99, p. 2258).

position thereto, and of the fact that the * * * [I. C. C.] * * * has made such or similar findings" (Section 725(3).²⁶

We submit that on this record the finding of the court below that the petition for approval of the plan was filed in "good faith" cannot be supported. We submit that the court erroneously applied to the facts the sole standard of "intentional fraud," and that, in view of the excellent financial condition of the Company, the demonstrated policy of the RFC, the enormous amount of salable collateral securing the RFC obligation and the failure of the Company's officers diligently to pursue obvious means of taking care of the RFC maturities, the petition by any proper standards cannot be held to have been filed in good faith. We further submit that it was an obvious fraud in the legal sense upon the jurisdiction of the court for the Company, upon such a flimsy basis, to proceed to effectuate another reorganization in the face of its representations and the same district court's findings and injunction in connection with the 1939 plan. And, finally we submit that unless corrected by this court, the decision below will serve as an encouragement to collusive petitions and will undermine the high standard of reorganization practice insisted upon by this Court and by the Congress. Review by this Court is of importance to the proper administration of Chapter X and Section 77 of the Bankruptcy Act, as well as Chapter XV and successor provisions which are pending passage by the Congress.

²⁶ When the original Chapter XV was before Congress Chairman Eastman of the ICC pointed out (see Hearings of the Sen. Com. on Interstate Commerce on H. R. 5407, 76th Cong. 1st Sess. (1939) 62) that consideration both by the Commission and the court of a plan submitted under that chapter would inevitably be affected by the fact that much time and money have already been spent on the plan at the time of its submission to them and that it has been accepted by a substantial number of interested parties. It was undoubtedly in recognition of this influence that Congress imposed upon the court the statutory duty in question.

III.

The court below erred in holding that the petition was properly filed and that the Company was "unable to meet its debts matured or about to mature." In so holding, the court erroneously applied this jurisdictional standard of Chapter XV (§ 710 (3); 11 U. S. C. § 1210 (3)); and as applied by the court to the facts of this case, the limits of the federal bankruptcy power were exceeded.

As we have discussed below and shall further show under this heading, the court's finding of the Company's inability to pay debts matured or about to mature amounts merely to a finding that it was inadvisable for the Company to do so: that it was in the Company's interest, and particularly that of its stockholders, to fail to meet an impending maturity so that it could resort to adjustment proceedings under the bankruptcy power. If such a finding were sustained it would provide a continuing inducement to corporations to resort to the bankruptcy power progressively to shake out the rights of their creditors, whether or not insolvency in the bankruptcy or equity sense exists. This would apply not only to railroads, but also to business corporations generally. Chapter X of the Bankruptcy Act, par. 130(1), 11 U. S. C. 530(1). To translate "inability" to meet debts into "inadvisability" would sanction abuse of the bankruptcy power, and lend the extraordinary sanction of this power to cases where necessity does not exist, and where the very existence of the power is at least doubtful. See *Continental Illinois National Bank and Trust Co. v. Chicago R. I. & P. Ry. Co.*, 294 U. S. 648, 673; *Hanover National Bank v. Moyses*, 186 U. S. 181; cf. *Canada So. R. Co. v. Gebhard*, 109 U. S. 527.

Further, the court's decision on this point permits and invites resort to the courts rather than to normal business methods of meeting debts. Whenever a debtor is dissatisfied with the conditions on which creditors will extend debts, the district court's construction would permit the debtor to make a case for reorganization by detailing the reasons

why it is beneficial to the debtor to reorganize. Such a radical departure in bankruptcy law should not be permitted to stand without review by this Court.

That the standard applied by the court below leads to unjust consequences is obvious from the facts of this case. The petitioner's Convertible bonds are to be stripped of valuable rights because the court below agreed that it was inadvisable for the Company to use any part of its huge, working capital, its swollen cash account, its liquid security-holdings or other resources to pay the RFC, or to permit the RFC to realize upon so much of its collateral as might be necessary.

There can be no question that if the Company had not been bent upon a general adjustment under Chapter XV to improve its equity position, ways could easily have been found to pay or to meet the RFC debt, without prejudice to the Company. Even if we assume that the RFC would have insisted upon payment (which it never did), that could have been made. And certainly, a very substantial payment on account could easily have been arranged, with extension of the balance or its liquidation by sale of collateral; and no party contended that the RFC would have rejected such an offer as against the extension of the entire debt to the RFC under the plan for a period of 20 years. It must be remembered that the Company, driven by its desire to force a readjustment planned at least as early as 1943, never made any such proposal to the RFC.

A brief statement of points will demonstrate the basis for our view that the court merely indulged the Company's desire for readjustment of its debt when it made the finding of inability to meet the RFC debt.

(a) The court below admits that the RFC loan of some \$81,000,000 is secured by collateral with a market value of \$172,000,000. Yet, it engages in market analysis and asserts that the present market value "is due to the prospect of success of this plan; and the failure of the plan would inevitably substantially impair public confidence in the future

prosperity of the Railroad with the consequent substantial decrease in the market value of the collateral" (p. 560 of 63 F. Supp.).²⁷ To permit courts generally to make such prognostications the basis for findings of inability to pay cannot but result in substantial deviation from existing standards concerning the application of the Bankruptcy Act and indeed of the scope of the bankruptcy power. Indeed, it is difficult to imagine that any presently foreseeable decline in the market value of the collateral pledged to secure the RFC loan would wipe out the margin between the obligation and the value of the collateral.

There can be no doubt that any contention is insupportable that enough of the pledged collateral could not be sold to satisfy, in whole or in substantial part, the RFC debt. Included in this collateral are certain securities which are not system securities such as the common stock of the reorganized Philadelphia & Reading Coal & Iron Co.; the stock of the Joliet & Chicago R. R. Co., a part of the Alton system; and a minority interest in the stock of the Southwestern Construction Company. These securities were found by the ICC to have an appraised or market value of over \$13,000,000 as of December 26, 1944. An additional sum could have been obtained by sale of the certificates of beneficial interest in the 165,544 shares of Western Maryland First Preferred Stock, which had as of the same date a market value of \$21,500,000 (PX 3, pp. 91-92).²⁸

²⁷ The court's statement omits the fact that the entire bond market has risen in this period. The court also omits to note that B. & O. bonds are quoted below the general market as shown by the Dow-Jones indices. (PX 99, p. 2258.) That B. & O. bonds have gone up since announcement of the plan may simply be an effect of the general rise or of their unduly low price prior thereto.

²⁸ The attitude of the court below is illustrated by its statement that the sale of the Western Maryland preferred "would be utterly disastrous to the unity of the B. and O. System, * * *" (p. 560 of 63 F. Supp.) This is contrary to the finding of the Interstate Commerce Commission, which has held that B. & O.'s ownership of this stock was in violation of the antitrust laws and of the Interstate Commerce Act (160 I. C. C. 785). (This ruling was not affected by the publication of the I. C. C.'s Four Party

It should be emphasized that these are merely illustrative. As Mr. Cassius M. Clay, who resigned as General Solicitor of the road in protest against these proceedings (*supra*, pp. 24-25) said: "I don't think an honest effort was made to meet the maturity in any way" (T. 1255).

Further proof of the Company's ability easily to meet the RFC debt is cited in the following points—

(b) As of December 31, 1945 (before the entry or the decree below), the Company had the largest net working capital it has had in over twenty years—roughly \$68,000,000. As of July 31, 1945, the Company's net working capital was \$51,000,000. (OX 31, p. 3485.) There was \$41,800,000 in cash and \$33,000,000 in cash investments (PX 86, p. 2068). It can hardly be disputed that a large amount of this could be used for application on the RFC debt. In fact, when the plan was before the I. C. C., the net working capital account was \$35,851,859 as of October 31, 1944 (the latest date for which figures were in evidence) which presumably was found by the I. C. C. to be adequate. See statement of Hand, J., *Delaware & H. R. Corporation v. Dancey*, 51 F. Supp. 763, at 765. On this basis, it may be assumed that \$15,000,000 from this account as of July 31, 1945, and \$32,000,000 as of December 31, 1945, was available for application to the RFC debt. Indeed, the basis in the record for the court's finding "that no substantial cash sum could fairly be presently withdrawn from current assets to apply on the 1944 maturities" (p. 556 of 63 F. Supp.) is the

Plan for the Eastern Region in July, 1932. 185 I. C. C. 403.) To this ruling B. & O. has submitted without appeal to the Courts, and the stock is trusteeed at the Commission's direction (183 I. C. C. 165). No attempt has been made by B. & O. to have the decree vacated or to terminate the trusteeship, or to acquire lawful control of the Western Maryland. 49 U. S. C. 5(2). Furthermore, sale of the First Preferred stock's certificates would still leave B. & O. with all its certificates of beneficial interest in Western Maryland Common and Second Preferred. President Daniel Willard frankly admitted in past years that there was no necessity for B. & O. to own this stock. (See Vol. 5, pp. 3618-9, *Railroad Combination in the Eastern Region*, Senate Report No. 1182, 76th Congress, 3rd Session.)

opinion of Mr. Snodgrass, Vice-President in charge of finance for the Company.²⁹ Even Mr. Snodgrass' opinion to this effect was based upon an April, 1945, balance sheet, and between that time and July (before the opinion of the court below), net working capital increased by \$15,000,000 (PX 48, PX 86, pp. 2008-9), and as of December, 1945 by \$32,000,000 (OX 2 (March), pp. 3505-6). The court, however, characterized the first improvement as making the figures "not very greatly different" (p. 556 of 63 F. Supp.). The second improvement was called to its attention but it held that was an insufficient reason for altering "the determination which we reached, and which we expressed in our opinion". It should further be noted that in February, 1945, in proceedings before the I. C. C. in connection with this plan, Mr. Snodgrass underestimated by roughly \$50,000,000 the amount of cash and government bonds which would be available as of December 31, 1945 (T. 1990-2002; PX 4, p. 100; OX 2 (March), pp. 3505-6).

(c) We are convinced that if the court had held the management of the Company to the standard of due diligence in endeavoring to meet the RFC debt as a requisite to resort to the extraordinary bankruptcy power, it would have found, merely by reference to the above facts, that the Company could not make the jurisdictional showing of inability to meet its debts matured or about to mature. If further support were needed for this conclusion, mention might be made to other sources of ready cash in addition to those al-

²⁹ Other witnesses testified it would be "inadvisable" to draw on working capital. None testified B. & O. would be "unable" to apply this capital to meeting the RFC debts. It should further be noted that Snodgrass's opinion that \$35,000,000 was reasonably required as net working capital was not supported by the facts as they developed within the next 8 months following April, 1945. The balance sheet items in evidence for June through December, 1945 show that B. & O. actually did not draw down on the capital balance that Snodgrass had testified was needed and that the huge accumulations of net working capital had been maintained idly without being put to productive use. (T. 1893-1896, OX 2 (March) pp. 3493-3506.)

ready mentioned: e.g., sale of \$3,500,000 First Mortgage Bonds held in the Company's treasury (PX 1, p. 18); and First Mortgage and Pittsburgh, Lake Erie and West Virginia bonds in the amount of \$9,000,000 which were cancelled after tentative approval of the plan by the Company's Board of Directors (OX 6 (March), pp. 3509, 3514-5). And it should also be recalled that, within a relatively short time prior to the RFC maturity, the Company deliberately diverted \$31,500,000 of its cash to purchase obligations maturing *after* the RFC debt.

We respectfully submit, therefore, that to permit a corporation to file a petition under the Bankruptcy Act, with the purpose and effect of degrading its obligations, in light of the circumstances of this case, is to condone and invite abuse of the statutory requirement in excess of the bankruptcy power. The flimsy pretext that the Company here was unable to meet its debt to the RFC must not be allowed to foreclose judicial inquiry into the statutory and constitutional basis for invoking the radical power of the bankruptcy court. A clear declaration by this Court of the necessity for unmistakable, non-colorable proof of inability to meet debts matured or about to mature is essential to proper administration of the law and to firm insistence by the courts upon the sanctity of corporate obligations in accordance with law and our constitutional system.

IV.

The court below erred in finding that the plan had been accepted by the requisite percentage of security-holders and that no misrepresentations were made in securing such acceptances. In so holding, it adopted a procedure which creates a dangerous precedent for other reorganizations. It decides a question of importance in the administration of the Bankruptcy Act in a clearly erroneous manner.

(a) The court made the finding required by Section 725 that the plan had been assented to and accepted by the requisite percentage of securityholders. In this it relied

exclusively on a statement by the management and the introduction in evidence of a mass of 39,000 acceptances so arranged that neither the court nor any securityholder could adequately check them. No list of all the affected bondholders was filed. Further, unique among railroad reorganizations, accepting bonds were not deposited nor were they stamped to indicate acceptance. (In the 1939 solicitation, bonds were deposited and certificates of deposit issued by the Company to evidence the accepted bonds.) Under the present scheme a transferee of a bond has no knowledge whether the previous holder has accepted the plan or not and without such notice is, of course, not bound by acceptance by the previous holder.³⁰ This is important in the light of the large activity in the B. & O. bonds. Thus, within the interval between the date of the management's first letter of solicitation and the entry of the court's decree approving and confirming the plan, more than thirty million dollars of the Convertible Bonds (approximately half of the total issue) were sold on the New York Stock Exchange. Under the circumstance a serious question exists both as to the quality and sufficiency of the proof offered by the management that the assents and acceptance of the various classes of bondholders had been obtained in the percentages required by the statute. Yet the court required no proof of the continued validity of the acceptances filed with it, a procedure which is a dangerous precedent for other reorganization proceedings.

(b) The court further failed to take into account the Company's unfair solicitation practices and in particular, a vital misrepresentation of fact which was used to induce acceptance of the plan.

In the Company's antecedent plan, the court in its decree of November 8, 1939, provided that if the Company should again file a petition "under any provision of the Bank-

³⁰ Stock brokers were paid for obtaining assents to a plan, but not for dissents. Thus an incentive was created for the purchase of bonds by brokerage houses and for their sale immediately after being assented.

ruptcy Act or other similar law at the time in force," all the interest made contingent by that plan should forthwith become fixed interest. In its solicitation literature the management represented to bondholders whose interest was made either wholly or partially contingent by the antecedent 1939 plan that such interest was *now contingent*. Despite the fact that the management issued letters of solicitation after the filing of its petition with the court below, in such subsequent letters it did not in any way call to the attention of the bondholders that all the interest on their bonds had become fixed by the filing of the petition, so that a grave question exists as to the validity of the assents obtained after the filing of the petition in the instant court proceeding. Since the assents obtained after the filing of the petition of July 2, 1945, are necessary to meet the statutory percentages, a substantial question exists concerning whether the statutory percentages had been attained.³¹ Yet although called to its attention the court below did not even mention the matter unless it be included in its general comment that there were no "material" misrepresentations.

CONCLUSION.

This case presents issues of fundamental importance, not only to the 80,000 bond holders of the Baltimore and Ohio Railroad Company, including the 41,000 non-assenters, but also to investors generally. It presents fundamental issues in the administration of the various chapters of the Bankruptcy Act relating to corporate reorganization and of Section 11(e) of the Public Utility Holding Act of 1935.

³¹ Indeed it is probable that the interest became fixed on December 4, 1944 when the petition under Chapter XV was filed with the I. C. C. This was before any soliciting literature was mailed so that the representation of existing contingency of interest was false even when originally made.

For the reasons stated, the petition for a writ of certiorari
should be granted.

Respectfully submitted,

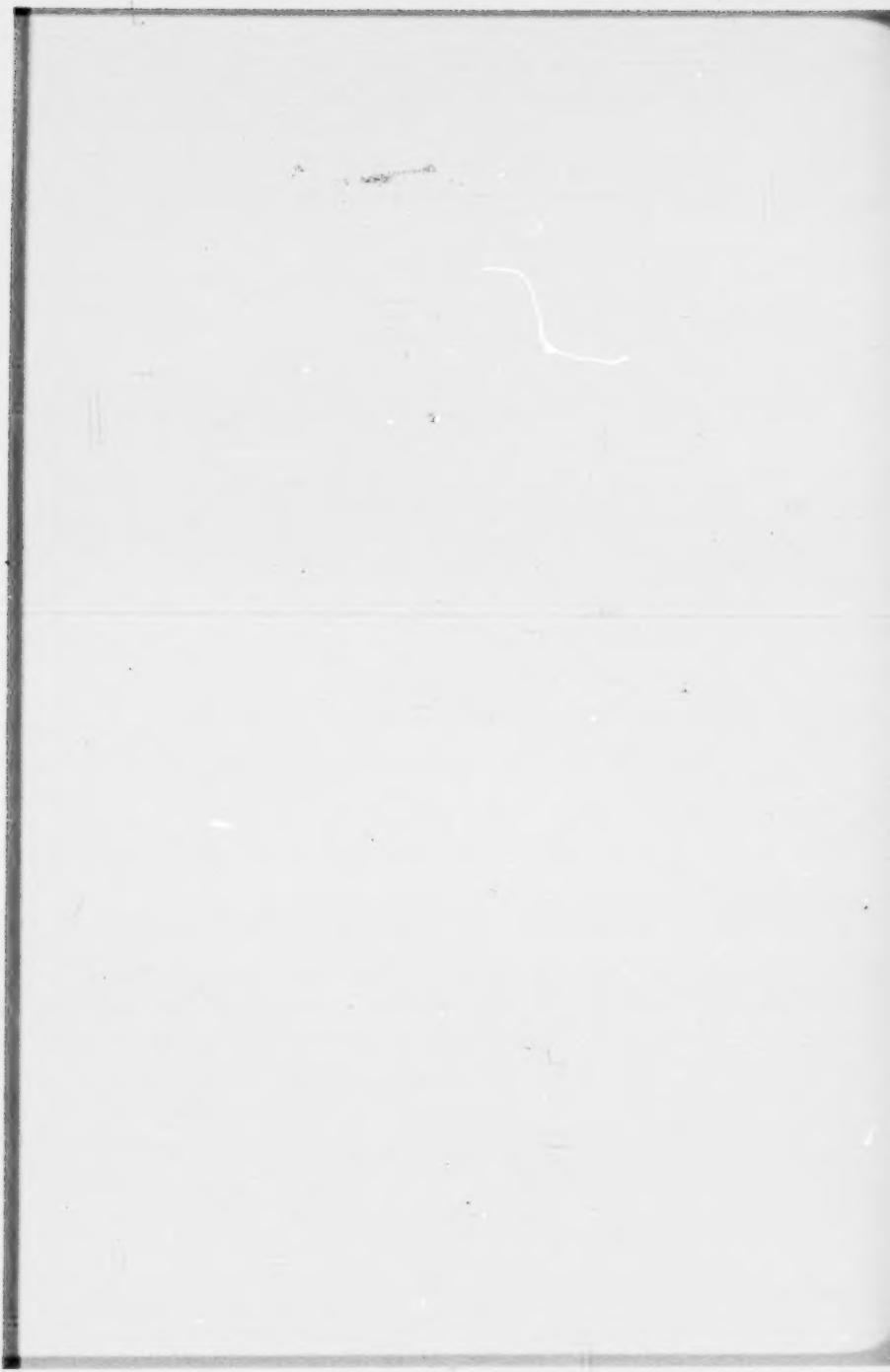
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May 11, 1946.





21 MAY 11 1946
CHARLES ELMORE DROPLEY
SUPREME COURT OF THE UNITED STATES CLERK

OCTOBER TERM, 1945

No. 1221

JANE CROZIER, ROBERTA GIESECKE AND HARRIET
M. ACKERT,

Petitioners,

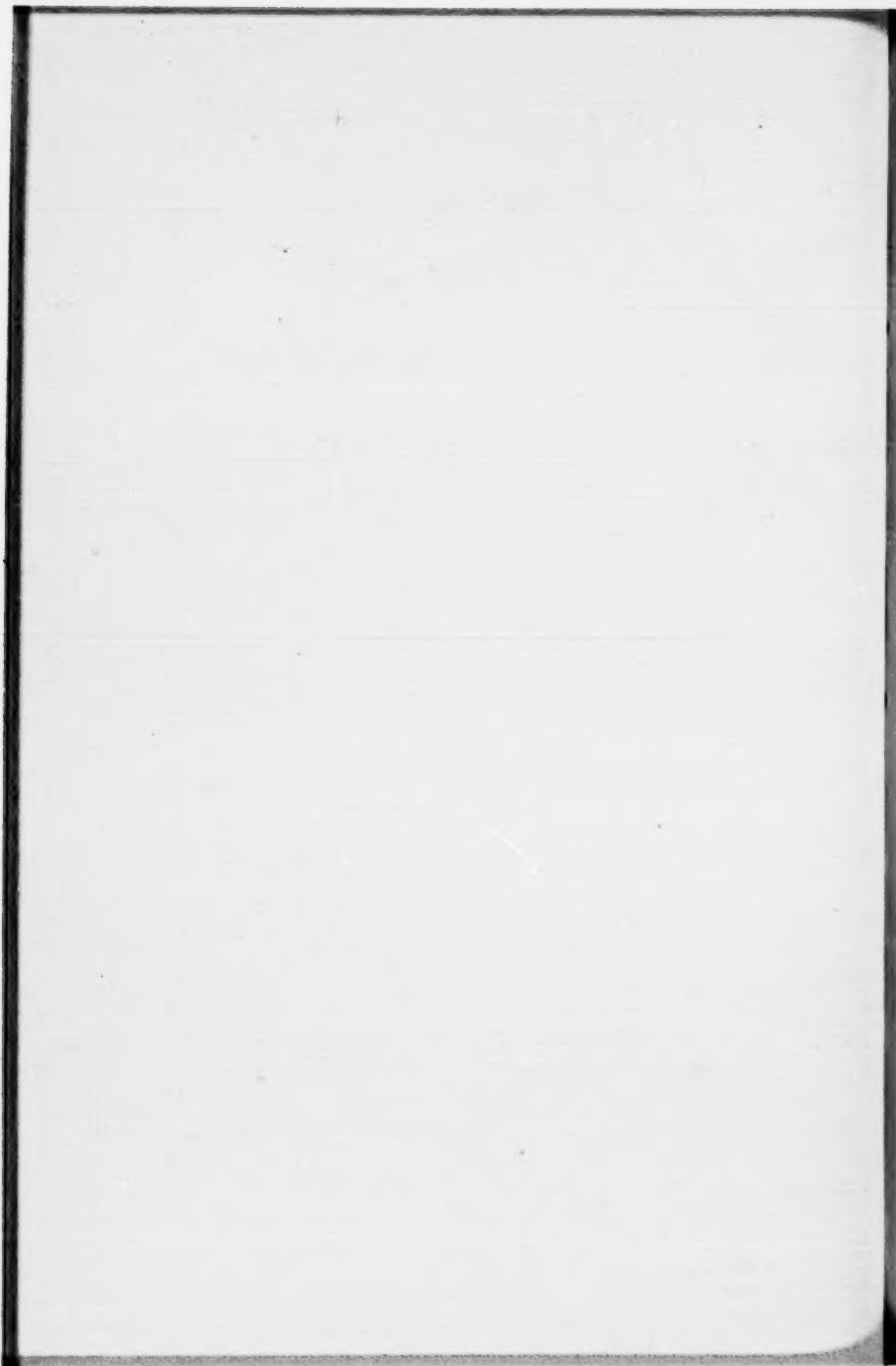
vs.

THE BALTIMORE AND OHIO RAILROAD COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE
DISTRICT COURT OF THE UNITED STATES FOR
THE DISTRICT OF MARYLAND AND BRIEF IN
SUPPORT THEREOF.

HAROLD C. ACKERT,
JOHN W. GIESECKE,
Counsel for Petitioners.

ACKERT, GIESECKE & WAUGH,
Of Counsel.



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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1945

No. 1221

JANE CROZIER, ROBERTA GIESECKE AND HARRIET
M. ACKERT,

vs.

Petitioners,

THE BALTIMORE AND OHIO RAILROAD COMPANY

**PETITION FOR A WRIT OF CERTIORARI TO THE
DISTRICT COURT OF THE UNITED STATES FOR
THE DISTRICT OF MARYLAND AND BRIEF IN
SUPPORT THEREOF.**

*To The Honorable Justices of the Supreme Court of the
United States:*

The Petition of Jane Crozier, Roberta Giesecke and
Harriet M. Ackert respectfully shows this Honorable Court:

A

Summary Statement of Matter Involved

The cause herein was originally instituted by the Baltimore & Ohio Railroad Company as a proceeding for a railroad adjustment under Chapter XV of the Bankruptcy

Act. The said cause was duly instituted by the filing of a petition in conventional form whereupon a special three-judge court, sitting as the District Court for the District of Maryland, was duly convened in the manner prescribed by Chapter XV of the Bankruptcy Act. The hearing provided by Sections 713 and 714 of said Chapter XV of the Bankruptcy Act was held on July 10, 1945, and at the close of said hearing the Court made statutory findings that the Petition was properly filed. In accordance with the Court's Order a hearing as required by Section 720 of said Act was duly held on September 17-21, 1945. At that time these Petitioners appeared and filed their Intervening Petition and Objections (R. 120), among which objections so filed with respect to the Plan as it affected the Baltimore & Ohio Railroad Company's Five Per Cent (5%) Refunding Mortgage Bonds, Series F, due 1996, was the following specific objection:

"The Adjustment Plan in the last paragraph of Article II, Par. 6, provides for the removal of a contractual restriction, contained in Article Seven, Par. 3, of the Refunding Mortgage and in Article Seven, Section 1 of the Supplemental Indenture thereto, against extension of any debt hereafter created and outstanding, and against extension of any senior debt presently outstanding and maturing after December 31, 1946 except with the consent of 66 $\frac{2}{3}$ % in principal amount of the Refunding Bonds. Such elimination of said restriction would be highly inequitable and tend to destroy any certainty holders of Refunding Bonds might have as to the ultimate retirement of senior indebtedness. The mere fact the company seeks a removal of such restriction by the present plan (which ostensibly looks forward sixty years) indicates a doubt on the part of the company as to the adequacy of the present proposed extension and adjustments. If the present plan is workable, feasible, and fair to the security holders, then no such elimination of the contractual rights of holders of Refunding Bonds against

further extensions should be needed. This Court in 1939 found that the 1938 Plan was not likely to be followed by the need of further financial reorganization or adjustment. Now, only six years later, it seems necessary, but surely no such drastic removal of an existing restriction now seems necessary because the partial removal of the restriction in the 1938 Plan was deemed adequate at a time when the Railroad was in a far more critical financial condition. To grant such a right to the Company would be, in effect, an unauthorized delegation of this Court's power to grant such extensions without submitting the matter to the jurisdiction of the court. Furthermore, it would grant to the Company a greater right of modification than is granted by Chapter XV, in that such Chapter requires approval of any such modification by 60% of bonds of each issue and 75% of all bonds affected thereby. By this provision sought in the Adjustment Plan, the Company seeks to gain an advantage not even authorized by Congress to come under the scrutiny of the court and the Interstate Commerce Commission. It is submitted that the provision approved by this court in the 1938 Plan is adequate, feasible, and as far as this court should go, both in law and as a matter of good conscience."

At the time the Refunding Bonds were issued, Article Seven, Section 3, the mortgage securing the same (R. 961) contained an express contractual provision prohibiting the extension or renewal of any prior lien indebtedness, reading in part as follows, to-wit:

"will not extend or renew any of such outstanding existing bonds so long as they are not deposited hereunder (except as aforesaid) and will not cause or suffer the same to be extended or renewed."

It was the admitted purpose of this provision to ultimately funnel all of the secured indebtedness of the company into this General and Refunding Mortgage (which at

its inception was a second mortgage) with the necessary result that the Refunding Mortgage would become a first lien.

Prior to the filing of the Railroad's Petition and in 1938 the Baltimore and Ohio Railroad Company had filed in the same Court a proceeding under the then Chapter XV of the Bankruptcy Act and in such proceeding proposed a plan of modification which was subsequently approved by the Court and effectuated by an instrument making appropriate changes in the bonds and the indenture securing them which provided among other things for certain adjustments which modified the above-set-out provision restricting extensions of prior-lien indebtedness so that any senior bonds of maturities after January 1, 1947, could be extended or renewed with the consent of the holders of sixty-six and two-thirds per cent (66 $\frac{2}{3}$ %) of the principal amount of Refunding Bonds at the time outstanding. The original mortgage securing said bonds was modified by a supplemental indenture dated January 1, 1940 (R. 1105), which provided in Article Seven, Section 1 thereof, as follows (R. 1105):

"There is hereby added after the second paragraph of Section 3 of Article Seven of the Refunding Mortgage a new paragraph as follows:

'Notwithstanding the foregoing provisions, the Railroad Company hereby expressly reserves the right to extend (on such terms and for such periods as the Railroad Company may from time to time determine) (a) any bonds or other indebtedness of any issue, all or any part of which was outstanding in the hands of the public on August 15, 1938, secured by a lien senior to that of the Refunding Mortgage and maturing prior to January 1, 1947, and (b) with the consent of holders of 66 $\frac{2}{3}$ % in principal amount of the Refunding Bonds at the time outstanding (excluding bonds pledged to secure other obligations of the Railroad Company and bonds in the treasury

of the Railroad Company) any such senior bonds or indebtedness of any later maturity or maturities.' "

As consideration for the adjustments made under the 1938 Plan with respect to the Refunding Mortgage Bonds, the holders thereof were given a new and additional right whereby they were granted the privilege of converting their Refunding Bonds into stock at a price specified in the Plan.

Under the 1944 Plan (R. 78), the one here under consideration, it was specifically provided:

"The Supplemental Indenture will also provide for the removal of any and all existing restrictions upon the extension, renewal or refunding of bonds of any issue or series, or any other debt, now or hereafter outstanding or pledged, secured by a lien senior to that of the Refunding Mortgage, to the end that any bonds or debt may be extended, renewed or refunded at any time, or from time to time, without the consent of the Refunding Bondholders or any of them."

The provision just quoted (which in reality would permanently relegate the Refunding Bonds to a secondary lien position instead of ultimately becoming a first lien as originally contemplated) is the one at which these Petitioners levelled their Objection No. 7 above set out. Nevertheless the Court below approved this provision of the Plan and approved a new Supplemental Indenture which specifically eliminated both the complete restriction as contained in the original Refunding Mortgage as well as the limited restriction requiring consent of the holders of two-thirds ($\frac{2}{3}$) of the Refunding Bonds as a condition precedent to any extension of prior lien indebtedness.

Other matters were, of course, embodied in the Objections filed by these Petitioners, and the Court's approval of the Plan, but statements relating thereto are here unnecessary as this petition is directed to the approval by the Court

below of this one particular provision of the Plan and the instruments intended to implement and effectuate the same and its overruling the objections of these Petitioners to that provision.

In reaching its conclusion that this provision of the Plan should be approved, the Court overlooked or ignored a basic objection to the elimination of the restriction against extension, namely, that it deprived Petitioners and other bondholders similarly situated of a vested contractual and property right without any compensation and went beyond the scope of a debt adjustment that is authorized by Chapter XV of the Bankruptcy Act. The Court disposed of the objection by saying, in part (63 F. Sup. l. c. 568): "Some of the intervenors (referring to these Petitioners) object to the features of the present plan which provide for refunding¹ the prior lien issues which, of course, is necessarily inconsistent with the covenants in the original refunding and convertible indentures." The Court then proceeded to dispose of the objection in the following very brief manner: "But as we have previously pointed out, we consider the refunding provisions of the present plan to be of real importance to the plan as a whole and really in the interest of all classes, including the refundings and convertibles, because it is quite possible that this privilege of refunding may take advantage of even existing lower interest rates with consequent reduction of interest charge." The Court did not review or discuss the applicable law. The objection was again called to the attention of the Court in these Petitioners' Motion for Reconsideration (R. 1625) but was again overruled by the entry of the Decree (R. 1936) (Order No. 4).

¹ It should be noted here that the Court below misconceived the scope of the objection, as no objection was made to "refunding" provided the maturity date of the bonds as extended by the 1944 Plan was not further extended or renewed.

B**Statement Disclosing Basis of Jurisdiction**

(1) The date of the Decree (Order No. 4), in this case was March 13, 1946.

(2) The jurisdiction of this Court is based upon the express language of Section 745 of Chapter XV of the Bankruptcy Act U. S. C. A. Title 11, Sec. 1245 and upon Judicial Code, Section 240, as amended by the Act of February 13, 1925, 43 Stat. 938, U. S. C. A. Title 28, Section 347.

C**Questions Presented**

(1) Whether the strict priorities rule as between stockholders and creditors and various classes of creditors and the requirement of "fair and equitable" as enunciated by this Court in *Northern Pacific v. Boyd*, 228 U. S. 482, 57 L. Ed. 931, *Case v. Los Angeles Lumber Products Company, Ltd.*, 308 U. S. 106, 84 L. Ed. 110, and kindred cases is applicable to a proceeding under Chapter XV of the Bankruptcy Act.

(2) Whether the deletion of the restrictive covenant against extension or renewal of prior liens as contained in the original indenture securing the Refunding Bonds and as modified by the Supplemental Indenture adopted and approved under the 1938 Plan violates such doctrine or goes beyond the jurisdiction conferred on the Court by Chapter XV of the Bankruptcy Act so as to prevent approval of the Plan unless modified by eliminating therefrom the provision removing such restrictive covenant.

(3) In the interests of brevity (*Rule 38, Paragraph 2, Furness Whitey Company, Ltd. v. Lang Tsze Insurance*

Association, Ltd., 242 U. S. 430), Petitioners do not at this time set forth all of the questions which will be urged in the argument of the merits of this cause, should the writ be granted, nor all of the contentions in support of such questions, but in order to comply with the rule of this Court requiring that all issues upon which a decision is requested be presented in the Petition for Certiorari (*Gunning v. Cooley*, 281 U. S. 90, 98), Petitioners here refer to and incorporate into this petition all of the matters presented in their Praeclipe for Record filed herein (R. 2033) (specifically paragraphs numbered 1 to 6 thereof) as points on which they intend to rely with the same force and effect as if herein set out in full.

D

Reasons Relied Upon For the Allowance of the Writ

Chapter XV of the Bankruptcy Act is an integral part of the bankruptcy legislation of this country and deals particularly with the adjustment of railroad finances. The exact scope of and the power of the court granted by this act have never been passed upon by this Court, with the result that the precise question as to how far the act permits adjustments to operate and whether actual cancellation of vested rights and express contract provisions of non-assenting bondholders is or could be authorized has never been authoritatively established.

In proceedings under this Act, in opinions expressed by legal and lay experts² and writers, the scope of the Court's

² Mr. Harry Haggerty, Vice-President and Treasurer in charge of investments of the Metropolitan Life Insurance Company, testified before the Senate Committee on Interstate Commerce on November 7, 1945 in connection with the hearings on Senate Bill 1253 as follows: "However, the lawyers of the Delaware and Hudson maintain that under the McLaughlin Act (Chapter XV) you could do just one thing, extend maturity, that you could do nothing else. Now if that is true—there is a difference of

jurisdiction under Chapter XV has been repeatedly questioned. The precise question here presented, to-wit, whether the *Boyd* and *Los Angeles Lumber Products Company* cases are applicable to Chapter XV proceedings, has likewise been the subject of much learned speculation and still remains unanswered.³ This has served as a hindrance to the preparation of plans, the judicial approval thereof, and has raised serious questions as to the necessity of further legislation⁴ to solve the financial difficulties of American railroads.

Although the Court below does not specifically cite the *Boyd* or the *Los Angeles Lumber Products Company* cases, it seems hardly likely that the Court below thought the strict priorities standard was required. As the plan was not submitted to stockholders for their assent, it may be assumed that their interests were not adversely affected. Admittedly the Refunding Bondholders are required to make concessions under the Plan, and it is difficult to see how the Court could have concluded as it did that the Plan was "fair and equitable" as an adjustment had it been applying the strict priorities doctrine of the *Boyd* and *Los Angeles* cases. An authoritative decision as to whether the

opinion among lawyers—there should be some way of giving greater latitude in the way of permitting comprehensive debt adjustment." Hearings before Committee on Interstate Commerce, United States Senate, First Session, on Senate 1253, page 29.

³ See University of Chicago Law Review, February, 1940, page 203; Corporate Reorganizations and American Bankruptcy Review, January 1946, page 136, dealing with the decision below in this case. Also see Gerdes in 1942 Annual Survey of American Law, page 555 (New York University School of Law, 1945), expressing the opinion that the strict priorities rule applies.

⁴ There is pending in Congress at the present time S. 1253 dealing with voluntary modifications of railroad financial structures where the precise scope of Chapter XV has repeatedly been under question. See hearings cited in Footnote 2 above; also see article in Traffic World, March, 1946, pp. 672 et seq.

absolute priorities doctrine is applicable to Chapter XV plans and whether concessions from stockholders must be required is of fundamental importance to large numbers of railroad security holders, to many railroads, to the trial courts convened under Chapter XV and to Congress. Basic also is the question whether the Act authorizes anything more than extensions and deferments as distinguished from the absolute annihilation of vested property rights.

E

Wherefore, it is respectfully submitted that the Writ of Certiorari herein applied for should be granted to review the judgment of the special three-judge court, sitting as the District Court for the District of Maryland.

HAROLD C. ACKERT,
JOHN W. GIESECKE,
Counsel for Petitioners.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1945

No. 1221

JANE CROZIER, ROBERTA GIESECKE AND
HARRIET M. ACKERT,

Petitioners,

vs.

THE BALTIMORE AND OHIO RAILROAD COMPANY

BRIEF IN SUPPORT

I

Opinion of the Court Below

The Opinion of the Special Court, sitting as the District Court of the United States for the District of Maryland, was rendered on November 20, 1945, and appears on Record pages 1549-1607 and is reported in 63 F. Supp. 542 (Advance Sheets).

II

Jurisdiction

The essential facts relative to the jurisdiction of the Court are fully stated in the accompanying Petition for Certiorari (*supra*, page 7), and in the interest of brevity are not repeated here.

III

Statement of Case

This case originated as a proceeding under Chapter XV of the Bankruptcy Act for the approval and confirmation of a plan of adjustment entitled "Adjustment Plan of the Baltimore and Ohio Railroad Company dated September 20, 1944, as Modified." The Plan affected eight (8) classes of creditors of the Railroad, holding claims as of August 31, 1944, in the principal amount of \$497,969,236. After hearings required by law, the Court made certain modifications in the Plan and rendered its Opinion under date of November 20, 1945. After an unavailing Motion for Re-consideration filed by these Petitioners (R. 1625), the Court entered its Decree approving the Plan on March 13, 1946 (R. 1936). Among the provisions of the Plan which were approved by the entry of said Decree was a provision which approved a Supplemental Indenture, supplementing the original Refunding Mortgage Indenture as modified by Supplemental Indenture dated January 1, 1940, all in accordance with the following provision of the Plan:

"The Supplemental Indenture will also provide for the removal of any and all existing restrictions upon the extension, renewal or refunding of bonds of any issue or series, or any other debt now or hereafter outstanding or pledged, secured by lien senior to that of the Refunding Mortgage to the end that any such bonds or debt may be extended, renewed or refunded at any time or from time to time without the consent of the Refunding Bondholders."

Prior to the approval of this Plan and the Supplemental Indenture implementing it, Article Seven, Section 1 of the Mortgage Indenture, as amended, securing the Refunding Mortgage Bonds provided:

"There is hereby added after the second paragraph of Section 3 of Article Seven of the Refunding Mortgage a new paragraph as follows:

'Notwithstanding the foregoing provisions, the Railroad Company hereby expressly reserves the right to extend (on such terms and for such periods as the Railroad Company may from time to time determine) (a) any bonds or other indebtedness of any issue, all or any part of which was outstanding in the hands of the public on August 15, 1938, secured by a lien senior to that of the Refunding Mortgage and maturing prior to January 1, 1947, and (b) with the consent of holders of 66 $\frac{2}{3}$ % in principal amount of the Refunding Bonds at the time outstanding (excluding bonds pledged to secure other obligations of the Railroad Company and bonds in the treasury of the Railroad Company) any such senior bonds or indebtedness of any later maturity or maturities.'"

By virtue of the approval of the quoted portion of the Plan the Court authorized the removal of the restrictive covenant against the extension or renewal of any other debt of the company whether now existing or hereafter outstanding, secured by a lien superior to the Refunding Mortgage, without the consent of any Refunding Bondholders. It is this action of the Court below that is involved in this petition.

IV

Specification of Errors

1. The Court erred in finding that the Adjustment Plan, as modified and approved, is in the best interests of the holders of Refunding and General Mortgage Bonds, is fair and equitable to the holders of said bonds as an adjustment, affords due recognition to the rights of the holders

of such bonds and affords a fair consideration to them, and that said Adjustment Plan, as modified and approved, conforms to the law of the land regarding the participation of said class of creditors and the stockholders.

2. The Court erred in approving the provision of the Adjustment Plan for the removal of the restriction contained in Article VII, Section 3, of the Refunding Mortgage, as amended by Article Seven Sec. 1 of the Supplemental Indenture thereto, in that such provision is unfair and inequitable to the Refunding Bondholders; goes beyond the debt adjustment authorized by Chapter XV of the Bankruptcy Act; grants to the Railroad an unauthorized delegation of the Special Court's power to grant extensions without submitting the matter to the jurisdiction of the Court; grants to the Railroad a greater right of debt modification than is granted by Chapter XV; is violative of the law announced by the decisions in *Northern Pacific v. Boyd*, 228 U. S. 482, 57 L. Ed. 931; *Kansas City Terminal R. Co. v. Central Union Trust Co.*, 271 U. S. 445, 70 L. Ed. 1028; *Case v. Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106, 84 L. Ed. 110, and kindred cases; and deprives the holders of Refunding Bonds of their property without due process of law and without due or just compensation in violation of the Fifth Amendment to the Constitution of the United States.

3. The Court erred in overruling Intervenors Crozier *et al.*, Point V (7) of their Objections and Intervening Petition (R.-120).

4. The Court erred in overruling Point 2 of Intervenors Crozier *et al.*, Motion for Reconsideration (R-1625).

5. The Court erred in finding that the Railroad's inability to meet its debts is reasonably expected to be temporary only, in approving the extension of the debt for period

from 30 to 50 years and finding thereby that the Adjustment Plan is not likely to be followed by need of further reorganization or adjustment, and in finding at the same time a necessity for removing the restrictions contained in Article VII, Section 3, of the Refunding Mortgage (PX 18) (R-961) as amended by Article Seven Sec. 1 of the Supplemental Mortgage (PX 19) (R-1105) thereto against further extensions than those called for by the Adjustment Plan.

6. The Court erred in its findings under Clause (3) of Section 725 of Chapter XV of the Bankruptcy Act in that its Opinion shows that in making such findings it was influenced by the extent of acceptances of such plan and the lack of opposition thereto; and that it was influenced by the fact that the Interstate Commerce Commission had authorized the modification of the securities as proposed by the Plan.

V

Argument

1

This Court in a long line of decisions commencing with the landmark decision of *Northern Pacific v. Boyd*, 228 U. S. 482, 57 L. Ed. 931, 33 S. Ct. 554, continuing through *Kansas City Terminal Railroad v. Central Union Trust Co.*, 271 U. S. 445, 70 L. Ed. 1028, and culminating in the relatively recent decisions of this Court in *Case v. Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106, 84 L. Ed. 110, 60 S. Ct. 1, and *Consolidated Rock Products v. DuBois*, 312 U. S. 510, 85 L. Ed. 982, 61 S. Ct. 675, has uniformly held that in any reorganization arrangement or plan enforced without the consent of the parties affected by it, the

vested rights of senior security holders cannot be reduced or infringed unless the junior security issues are eliminated or make appropriate substantial concessions to serve as consideration for any reduction in senior rights. Stated conversely, the rule is that any plan by which subordinate rights and interests of stockholders are attempted to be secured at the expense of the prior rights of other security holders, is unfair and inequitable and will not be judicially sanctioned.

This rule has become well known as the doctrine of absolute priority. It has been specifically applied to equity receiverships as well as to corporate bankruptcy proceedings under Section 77b and Chapter X, to municipal reorganizations under Chapter IX and to railroad bankruptcies under Section 77. It has been applied to both solvent and insolvent companies.

The words "fair and equitable" have in reality become words of art which require the application of the principles of the *Boyd* and parallel cases.

Chapter XV of the Bankruptcy Act has never been before this Court in a decided case, and consequently there is no authoritative decision of this Court determining whether Section 725(3) of said Chapter XV requires application of the principles of the *Boyd* case. On the face of it no reason is apparent why any different rule than the doctrine of strict priority should apply under Chapter XV of the Bankruptcy Act unless Congress in enacting it had otherwise expressly stated, which it did not.

Chapter XV became a part of the Bankruptcy Act on July 28, 1939 and expired by its own terms on July 31, 1940, (Pub. No. 242, 76 Cong. 393, 1st Session.) The McLaughlin Act, the present Chapter XV, was a re-enactment and varies in no respect here pertinent from the original Chapter XV.

The present Chapter XV expired, except as to pending proceedings, by its own terms on November 15, 1945.⁵

Congress in passing the original Chapter XV and the subsequent McLaughlin Act unquestionably intended to specifically incorporate therein the principles of the *Boyd* decision. This is made clear by specific statements to that effect in both the House and Senate Reports (H. R. No. 338, 76th Cong., 1st Session, page 3; S. R. No. 487, 76th Cong., 1st Session, page 7; H. R. No. 2177, 77th Cong., 2nd Session, page 5; S. R. No. 1617, 77th Cong., 2nd Session, pages 4 and 5).⁶

That the principles of the *Boyd* case were specifically incorporated in Chapter XV is the conclusion of Professor Gerdes in writing the chapter, "Bankruptcy and Corporate Reorganizations," in the 1942 *Annual Survey of American Law* where at page 555 he discusses the precise question here under consideration, saying:

"The requirement that the plan be 'fair and equitable' incorporates the absolute priority theory which prohibits recognition in the plan of any interest of junior creditors or stockholders having no equity in the assets of the debtor unless new consideration is paid by them."

⁵ A bill to revive Chapter XV has already passed the House without a dissenting vote and is now pending in the Senate, and another bill (S. 1253, 79th Cong., 2nd Session) which purports to adopt "the basic principle of Chapter XV procedure in authorizing reorganization without forfeiture of either bonds or stock" (S. R. No. 1170, 79th Cong., 2nd Session, page 145) has passed the Senate and is pending in the House. This latter bill would largely, if not entirely, supersede Section 77 proceedings and would become the permanent bankruptcy procedure for railroad reorganization.

⁶ Colonel Anderson, who was Chief Counsel for the Baltimore & Ohio in connection with securing court approval of the 1938 Plan and who was active in securing the original passage of Chapter XV, stated at the time of the prior case that the words "fair and equitable" as used in the Act were understood by the Congressional Committees and by the Interstate Commerce Commission to incorporate the principles of the *Boyd* case.

Certain fundamental distinctions exist between a Section 77 railroad reorganization and a Chapter XV reorganization. Under Chapter XV the Interstate Commerce Commission does not pass on the basic legal requirement of fairness and equitableness. It conducts no poll to determine assenting shareholders, the plan having already originated with the management (the stockholders), and certain assents are required to have been obtained before the matter reaches the Commission. It is not until after the Plan has reached the Court and the final requisite number of security holders have consented that any judicial determination of the fairness and equitableness of the Plan is required. Under such a procedure, coupled with the fact that any such Plan is of necessity a management plan (and presumptively is in the interest of stockholders), it is inconceivable that a test of fairness and equitableness less strict than that required in all other forms of bankruptcy and equity proceedings could possibly be contemplated.

It is submitted that the rule of absolute priority is fully applicable to Chapter XV proceedings.

2

The railroad's covenant with the Refunding Bondholders against the extension or renewal of prior mortgages is a fixed property right. It is entirely surrendered under the present Plan. The strategic position of the Refunding Bondholders to in reality ultimately become prior lien bondholders is greatly weakened thereby, if not in fact completely lost. That this is a valuable right, protection against the loss of which is guaranteed by the *Boyd* case, is abundantly clear from the language of this Court in the somewhat similar situation ruled upon in the *Consolidated Rock Products* case, *supra*, where at page 528 in the Official Reports, this Court, after stating that the "relative priorities" had been maintained, went on to say:

"But the bondholders have not been made whole. They have received an inferior grade of security, inferior in the sense that the interest rate has been reduced. A contingent return has been substituted for a fixed one, the maturities have been in part extended and in part eliminated by the substitution of preferred stock, *and their former strategic position has been weakened. Those lost rights are of value.* Full compensatory provisions must be made for the entire bundle of rights which the creditors surrender." (Emphasis supplied.)

In the case at bar the opinion of the Court below does not suggest that the Refunding Bondholders have received any compensation for this valuable right which they are required to surrender. While admitting that the deprivation of this contractual right "is necessarily inconsistent with these covenants in the original Refunding * * * Indentures," the Court below disposed of the point by the weak statement that, "But as we have previously pointed out, we consider the refunding provisions of the present Plan to be of real importance to the Plan as a whole and really in the interests of all classes, including the Refundings and Convertibles, because it is quite possible that this privilege of refunding may take advantage of even existing lower interest rates with consequent reduction of interest charges." The Court completely failed to consider whether there was any adequate compensation for surrender of this right by the test of the *Boyd* case, and, in fact, neither that case nor any of the parallel cases following it are mentioned in the lengthy Opinion of the Court below. If it should be thought that while the Court below did not expressly hold that said principles were applicable it was in fact trying to apply those principles, then its conception of compensation for the surrendered rights, as gleaned from the foregoing quotation, is wholly inadequate to support the conclusion reached.

In the first place, the Court has unquestionably misconceived the objection of these Petitioners (Intervenors below). We did not object to a *refunding* to permit the Railroad to secure a lower interest rate so long as such refunding does not violate the contractual right of these holders against an extension or renewal of such prior lien bonds *beyond the new maturities thereof as provided for in the Plan*. The only recognition (if it may be called such) in the opinion of this point is a short paragraph on page 568 of the Opinion. There the Court says the indentures securing both the Refundings and the Convertibles contain prohibitions against the Railroad making any "new" mortgages to take precedence over them. We know of no such provision in the Refunding Mortgage—it contains, instead, the covenant against extension or renewal, the removal of which by the Plan we oppose. On the other hand, the Convertibles Indenture does contain a prohibition against any new mortgages to take precedence over them, but does not contain a restriction against extension or renewal of existing prior mortgages. Obviously the Court was confused and overruled our objection without understanding it. And strangely enough, we do not find in the Plan any provision calling for the removal from the Convertibles Indenture of the prohibition against "new" mortgages to take precedence over them. Surely this is confusion confounded, and not indicative of a ruling upon our objection based upon an understanding of the issues. No reason is suggested why, if the prior lien bonds could be refunded at all, they could not be refunded with the same maturities to which they are extended under the Plan, thus gaining the advantage of a lower interest rate without violating the covenant against *extension or renewal*. This Court will undoubtedly take judicial notice of the fact that in refunding operations the shorter the maturity, the lower rate of interest that can be obtained. As the prior lien bonds as extended by the

Plan will not mature for many years, it seems perfectly self evident that any refunding beneficial in reducing interest could be effected without further extending or renewing the new bonds as set up under the Plan.

In the second place, it is error for the Court below to take the position that merely because *refunding* provisions are of importance to the Plan as a whole (which, of course, means retaining the stockholders' interest intact), such fact affords compensation for the taking away from the Refunding Bondholders the covenant against *extensions* or *renewals*. Certainly, the mere fact that if a plan is not adopted a more drastic reorganization will result does not constitute compensation. Even in a more drastic reorganization (such as under Section 77) the Refunding Bondholders' right to complete priority over the stockholders would be guaranteed. There would be no loss to them if such an eventuality developed. Moreover, as this Court said in the *Los Angeles Lumber Products* case, the avoidance of liquidation is not consideration satisfying the absolute priorities rule. That a more drastic reorganization would result, in the event of the failure of this Plan, is directly contrary to the express statutory finding which the Court below was required to make and did make before approving this Plan, namely, that the Railroad is not in need of a Section 77 reorganization.

The nearest the Court below comes to actually finding any consideration moving to the Bondholders is at 63 F. Supp.; S. C. 561, when it states:

"By the plan each of these classes (Refundings included) is required to make certain concessions or, if you please, sacrifices in the recapitalization. It is clear, we think, that the aggregate of the respective sacrifices to the plan as a whole *greatly improves the position of the Railroad* and adds to the prospect of its long continued prosperity as a going concern. In

this bettered position of the entity each of the affected classes participates and is itself bettered *at least in public estimation* as reflected in Moody's Rate Manual." (Emphasis and parenthetical words supplied.)

Lastly, the Court below suggests that the saving in interest rates that might result from refunding is in the interest of all classes. This is indeed a specious argument. If interest rates were reduced, the obvious result would be increased net earnings. The bondholders' ultimate claim upon those earnings are fixed and will not be increased by the prosperity of the road whether that prosperity results from better business conditions, decreased operating costs, or savings in debt charges. The real beneficiaries of any reduced interest are the stockholders, not the bondholders. In other words, this statement of the Court below accentuates the fact that the only real advantage that can come from this provision is the possible increased earnings which would, at the expense of the Refunding Bondholders, further line the pockets of the stockholders, who give up absolutely nothing under the Plan and whose rights are in no wise affected by it. Far from being a consideration passing to the Refunding Bondholders, the very argument which the Court below makes shows that the consideration passes to the stockholders and that can be no basis for depriving the Refunding Bondholders of this valuable covenant and is violative of the principles of the *Boyd* case.

3

The original Refunding Mortgage catagorically prohibits any *extension* or *renewal* of any prior lien bonds. The 1938 Plan modified this provision by permitting such renewal or extension with the consent of the holders of two-thirds ($\frac{2}{3}$) of the bonds. For the partial surrender and modification of this right by the 1938 Plan it gave

the Refunding Bonds a conversion privilege not previously enjoyed by them. The present Plan eliminates the two-thirds ($\frac{2}{3}$) consent requirement and allows the unrestricted extension or renewal of any prior mortgage bonds without any action or consent by the Refunding Bondholders and, in fact, over their express objection. The Refunding Bondholders under the present Plan receive nothing for this express right that has been taken away from them by the present Plan. Chapter XV of the Bankruptcy Act, under which this proceeding is brought, expressly requires the Court to find that the Railroad's inability to meet its debts is reasonably expected to be temporary only. The Court is further required to expressly find that the present Plan is not likely to be followed by the insolvency of the Petitioner or by need of financial reorganization or adjustment. Therefore, the Court in order to approve this Plan must and did find that the present situation in which the Railroad finds itself is temporary only and that the new scheme of extended maturities can be met at their respective due dates. This being true, it follows that the Court must find that the prior mortgage bonds can be paid at their maturity as extended under this Plan. Therefore, there would be no necessity for extension or renewal of said bonds as so extended by this Plan, and there is, therefore, no necessity for eliminating and taking away from Refunding Bondholders the presently existing provisions prohibiting such extension or renewal of prior mortgage bonds except upon the consent of the holders of two-thirds ($\frac{2}{3}$) of the Refunding Bonds. To hold, as the Court below did, that such provision is fair and equitable is wholly inconsistent with the required findings under Chapter XV of the Bankruptcy Act that the Petitioner's present position is temporary only and that it will not need further financial reorganization or adjustment, which finding the Court below actually made. This is particularly evident

when notice is taken of the fact that the provision of the Plan annihilating the covenant against extension will not be of any actual effect until forty (40) years from now. Until then, the bonds do not mature. So the Court is approving a provision to take effect forty (40) years later, while finding now that the present long-range Plan is not likely to be followed by need of financial adjustment.

A comparison of the present Plan with the 1938 Plan well illustrates how unnecessary is this provision. Under the 1938 Plan the original provision was modified so that a debt maturing before January 1, 1947, could be extended, with the consent of the holders of 66 $\frac{2}{3}$ % in principal amount of the Refunding Bonds outstanding. This was deemed adequate in 1939 at a time when the company had large maturities coming up in 1944, 1948, 1951, etc., when the railroad's debt was \$110,000,000 larger, the maturities much nearer and their ability to pay far less. Can it be said reasonably that the Petitioner needs greater concessions from the Refundings than were extracted under the 1938 Plan? Can it be said as a matter of law that such a provision of the Plan is fair and equitable when stockholders are required to make no concessions whatsoever?

One of the principal inducements made to the holders of the Refunding Bonds and the theory behind the original issuance thereof was the representation and assurance that by 1951 they would have for all practical purposes a first lien. The 1938 Plan whittled away a part of that assurance by reducing the number of holders of principal amount of Refunding Bonds that must consent to an extension of prior liens. Any extension has the effect of continuing the subordinate position of the Refundings for a greater period than was originally contemplated. The

present Plan as approved by the Court below has entirely eliminated this assurance of ultimately having a prior mortgage position because now the railroad company can extend into perpetuity its prior liens not only without the consent of the Refundings but against their active opposition, so that in fact the Refundings may never become a first mortgage and undoubtedly will be left as a second mortgage on properties of the railroad. This is being done without any concessions whatever from the stockholders.

A glance at Petitioners' Exhibit 89 (R. 2013) will show that by the payment of two relatively small issues the Refunding Bonds would constitute a first lien on a greater trackage than the other prior lien bonds now have. As a matter of fact, payment of the \$37,000,000 P. L. E. and W. Va. bonds would give the Refundings a first lien on the very heart of the Baltimore & Ohio System, as the present First Mortgage issues are only on the eastern lines and the Chicago extension—two disconnected segments which could not be satisfactorily operated without the mileage covered by the P. L. E. and W. Va. Mortgage. Then, if in addition the \$37,000,000 of S. W. Division bonds were paid, the Refundings would have a first lien on more system mileage than the First Mortgage issues, including the vital center section. Absent the Plan, the P. L. E. and W. Va. bonds are due in 1951 and the S. W. Division bonds are due in 1950, and would have to be paid then. The Plan extends both issues to 1980—a very great sacrifice the Refundings make in that particular alone—and yet the Court would approve the provision objected to and let the Road further extend those issues in 1980 without either approval of the Court or the Refunding Bondholders. The very real value of the covenant against extension or renewal is thus readily apparent.

With the restrictive provision contained in the mortgage the Refunding Bondholders could confidently look forward to the maintenance of their present lien position and with the prospect that in 1980 there would be a distinct improvement thereof in accordance with the contemplation of the original covenant of the Refunding Mortgage. By the Plan they are deprived of their present position and instead of being able to look forward to an improvement of that position, they are now faced with the practical certainty of the continuance of a subordinate, and even a further subordinated, position for all future time.

The drastic curtailment of the Refunding Bondholders' rights by the complete elimination of the restrictive covenant can further be recognized by another comparison with the 1938 Plan. While that Plan reduced the requirement for extension or renewal from unanimous consent to consent by holders of two-thirds ($\frac{2}{3}$) of the Refunding Bonds, such a provision could in part be justified by the practicalities of the situation, for it is obviously difficult to secure unanimous consent from a large group of bondholders. It usually happens that some bondholders become completely lost and cannot be located to secure their consent even though they are not active opponents. Furthermore, under the modern concept of bankruptcy legislation it is usual and customary that the consent of two-thirds ($\frac{2}{3}$) can control minorities. Under Chapter XV a mortgage could be extended or renewed with such percentage of consent. Therefore, it would not seem entirely unreasonable to reduce the percentage required under the contract to a percentage comparable with the number that would have to consent to secure court approval. However, when the court approves a plan which completely eliminates any requirement for the consent of any bondholders and allows extension and renewal without any consent and over active opposition, the court is in effect delegating its powers under

Chapter XV or any act then in force. Congress obviously did not intend to let the court in effect approve a plan granting long extensions and then add: "If these aren't long enough, do it yourself next time and don't come back here." The Refunding Bondholders at this time are compelled for all time in the future to accept the action of the management (which, of course, in reality is the stockholders) without court approval to continually keep their rights submerged. Such action of the stockholders can be exercised as their whim may dictate and whether or not any necessity exists and without subjecting their action to the scrutiny or approval of any court.

The provision approved in the 1938 Plan, while not entirely free from question as to validity, certainly represents the outside limit to which the court in a Chapter XV proceeding can go in affecting the rights of the Refunding Bondholders. Moreover, it must be remembered that as the consideration for this concession in the 1938 Plan the Refunding Bondholders did receive a conversion privilege, something which they previously did not have. It might be noted that no similar concession was made or new right given under the 1938 Plan to any prior-lien bondholders, as no rights were being absolutely taken away from them; they were merely having their rights deferred rather than eliminated. The concession to the Refundings was unquestionably given as compensation for the taking away of a portion of their covenant against extension or renewal. Under the present plan the entire right is taken away. No comparable consideration is given.

This objected to provisions of the Plan as approved by the Court below deprives the Refunding Bondholders of their property without due process of law and violates the provisions of the Fifth Amendment to the Constitution of

the United States, as there is no consideration whatever passing to such bondholders for the compelled surrender of the right. It is perfectly clear that a valuable right has been taken away from the Refunding Bondholders. An over-all examination of the Plan clearly indicates that no objective standard was used by the Railroad in preparing the Plan, or by the Court below in approving it, to determine the relative value of the different mortgages. As a practical matter, the Refunding Mortgage, as above shown, has been relegated permanently to a second-lien position (without any reference to Exhibit 89, which shows how easily it might become a superior mortgage to the so-called First Mortgage Bonds and without any reference to the fact that upon discharge of all prior liens it would become a first lien upon the entire system). No concession has been extracted from the stockholders. These matters all point to a flagrant violation of the Constitutional Amendment and a deprivation of the Refunding Bondholders' property without due process of law and without just compensation.

6

The foregoing argument has assumed that the Refunding Bondholders have received no consideration whatever for the surrender of the right that has been herein discussed. We think that what we have said sufficiently makes this clear. Admittedly there is no provision for compensation such as was contained in the 1938 Plan (the granting of a conversion privilege). The Opinion of the lower Court has not pointed to any compensation or consideration moving to the Refunding Bonds, although as discussed under 2 above, the Court suggested that it was to the interest of the Plan as a whole and the Refunding Bondholders, but without a showing of any actual consideration. Such an unsupported conclusion not only begs the question, but fails

to answer it for the reasons we have discussed under 2 above. It is also suggested in the Opinion of the Court below that the elimination of the covenant is necessary for "flexibility." Apparently the argument is that the railroad needs assurance against foreclosure of prior liens at maturity. However, that argument is inconsistent with the finding that the Plan creates a sound financial structure for the railroad and will not be followed by further reorganization or adjustment. Furthermore, if in the future the Refunding Bonds were actually faced with a probability that prior liens would be foreclosed and their security wiped out, can it be reasonably argued or thought that any difficulty would be encountered in securing the approval of the holders of two-thirds ($\frac{2}{3}$) of the then outstanding bonds? Their self-interest would dictate rapid and active cooperation under such circumstances. There is no justification for capriciously completely eliminating at this time their right to disapprove extensions or renewals which may be conjured up in the future solely by the stockholders acting through the management in their own self interest.

The above are the only matters which the Court below even remotely suggested constituted consideration. However, the Railroad in its brief below asserted that such matters as the creation of a sinking fund, a capital fund, and some similar provisions of the Plan would constitute consideration. Such claims are of so little merit that they hardly need be answered. Suffice it to say that the inclusion in the Plan or the implementing mortgages of features normally common in such situations do not raise such features to the dignity of compensation. This Court made that entirely clear in its opinion in *Group of Institutional Investors v. C. M. St. P. & P. Railroad*, 318 U. S. 523, l. c. 571, 87 L. Ed. 960, l. c. 1010, where it was said:

"Certainly we cannot say that the inclusion in the new securities to be received by the General Mortgage Bonds of features normally common to them are adequate compensation for the lost seniority," and at pages 569/570 where it was again emphasized that creditors "must receive, in addition, compensation for the senior rights which they are to surrender * * * unless this principle is respected, there will be serious invasion of the rights of senior claimants to the benefit of junior interest. The property of one group will be subtly appropriated to pay the claims of another while lip service is rendered to the principles of priorities."

Our argument so far has proceeded upon the theory that under Chapter XV a radical change in the rights of security holders is permissible so long as the absolute priority doctrine is scrupulously enforced. However, it also seems clear that no deprivation of a fixed or vested right was even within the Congressional contemplation of Chapter XV.⁷

The very distinctions which the Congress made between Chapter XV proceedings and Section 77 proceedings, particularly the requirement of Chapter XV that the railroad be not in need of a Section 77 reorganization, are suggestive of an underlying fundamental distinction between the type of relief that can be granted under the two acts. Sec-

⁷ See H. R. Hearings on H. R. No. 3704 and H. R. No. 5704, 76th Con., 1st Session, page 83. Mr. Harry Haggerty, Vice-President and Treasurer in Charge of Investments of the Metropolitan Life Insurance Company, testified before the Senate Committee on Interstate Commerce on November 7, 1945 in connection with the hearings on Senate Bill 1253 as follows: "However, the lawyers of the Delaware and Hudson maintain that under the McLaughlin Act (Chapter XV) you could do just one thing, extend maturity, that you could do nothing else. Now if that is true—there is a difference of opinion among lawyers—there should be some way of giving greater latitude in the way of permitting comprehensive debt adjustment." Hearings before Committee on Interstate Commerce, U. S Senate, 1st Session, on Senate 1253, page 29.

tion 77 grants complete latitude and permits the complete annihilation of the interests of security holders found to have no equity in the company. Chapter XV, on the other hand, provides for *adjustments*, deferments of rights but not the annihilation of them.

Chapter XV contemplates a solvent railroad.⁸ Obviously a solvent railroad does not need a radical reorganization in the sense that any class of security holders need be eliminated. It would seem to follow that it is highly questionable whether a solvent railroad should ever be permitted to extract any vested right from a creditor. Under the absolute priority doctrine this could not be done unless the stock made a real and valuable concession, and as we have seen, Chapter XV contemplates leaving the stock interests untouched. Therefore, it seems clear that basically no vested right could be taken away from any class of creditors under Chapter XV as there is no practicable way of obtaining a real and valuable concession from the stock when it is left untouched.⁹ Furthermore, if the annihilation of substantial rights can be forced upon creditors in a Chapter XV proceeding (even if the absolute priorities rule is enforced), it is then difficult to see how Chapter XV substantially differs from Section 77. It would be mere duplication and surplusage. Such intention cannot be imputed to Congress.

⁸ 1942 Annual Survey of American Law (New York University School of Law), page 554.

⁹ About the only practical way of receiving compensation would be the means actually used by the Baltimore & Ohio under their 1938 Plan when the stockholders gave the Refunding Bondholders a conversion privilege as compensation for the change that was then made in the same indenture provision, the complete elimination of which is now objected to. While this consideration momentarily left the stock untouched, it did provide the means whereby the stock could be diluted and thereby affect the stock interest and at the same time afforded to Refunding Bondholders a real consideration for what they were required to give up inasmuch as it afforded an opportunity to share in future prosperity of the company.

Apparently even the lower Court feels that Chapter XV limits the "adjustments" allowed to those which do not annihilate creditors' rights. As proof of this, the opinion shows the court, in every instance when discussing the features of the Plan, states repeatedly that the Plan only postpones creditors' rights. At 63 F. Supp. i. c. 547/8 the Court says:

"The principal features of the adjustment plan now submitted * * * consist in the extensions of the maturity of five of its large bond issues and in providing that a certain portion of fixed interest on some of the issues be made payable only contingently upon earnings sufficient therefor, but to be fully cumulative until finally fully paid. The plan contemplates that the security for existing obligations of the Company remain unchanged."

At l. c. 548/9, referring to other "carefully worded" provisions of the Plan, the Court has either overlooked or carefully avoided the provision of the Plan here under discussion, which is a provision which contemplates changing and *diminishing* the security for the Refunding Bonds. Nor is the provision even touched upon under the part of the Opinion labeled, "Consideration of Fairness of the Plan." Yet, on page 551 the Court says that a study of the main features of the Plan leads the Court to the conclusion it is fair and equitable. While not examining or referring to the provision we here challenge, the Court at l. c. 552 again asserts the Plan does not "impair any of the present security for the several affected issues respectively. It merely *postpones* the maturities * * * and possibly some of the interest thereon."

At l. c. 561 the Court concludes the Plan conforms to Legal standards because "There is no reduction of the amount of contractual obligation of the B. & O. for either principal or interest, and no impairment of the security

therefor. The only change is postponement of maturity of principal, and the time of payment of interest made contingent upon earnings, but fully cumulative until finally paid." Also at l. c. 561 the Court infers that all the Refunding Bonds *yield* is a portion of their fixed and secured interest to contingent interest, the latter payable, however, prior to unsecured contingent interest.

Creditors, of course, make concessions under Chapter XV, but the concessions that have been generally recognized¹⁰ are only those which postpone rights and do not obliterate them. Mere postponement is simply equivalent to a moratorium and is not objectionable constitutionally or otherwise without stockholders' concessions.¹¹

The Interstate Commerce Commission, in a letter from its Chairman to Congressman Sumners (reported in H. R. Hearings on H. R. 3704 and H. R. 5704, 76th Cong., 1st Sess., at page 83) expressed their opinion that *deferment* plans are the only type a court can approve under Chapter XV. And in PX 3, herein (Report of the I. C. C. on the plan here—R. 49), the decision of the Interstate Commerce Commission contains this statement:

"We are of the opinion that the plan would be improved if the contingent interest were not to be fully cumulative, but any plan containing provisions that would call for less than all the interest payments prescribed by the original terms of the bonds would not be consistent with an adjustment of this character
 * * *."

¹⁰ All of the plans that were approved under prior Chapter XV with the exception of the Baltimore & Ohio scrupulously avoided deprivation of contractual rights. They involved in the main mere extension of maturities (often with partial payments on account) and sometimes, similar to the Baltimore & Ohio, made part of the interest contingent but fully cumulative.

¹¹ *Home Bldg. & Loan Association v. Blaisdell*, 290 U. S. 398, 78 L. Ed. 413, 54 S. Ct. 231, 88 A. L. R. 1481.

One of the injunctions placed upon the Court below by Chapter XV is that the Court shall make its review and findings independently of the percentages of acceptances by security holders or lack of opposition thereto. The Court below, although giving lip service to this injunction, was obviously influenced in its thinking both by the apparently large number of acceptances and the lack of sizeable opposition. At 63 F. Supp., l. c. 553, the Court said:

"It is relevant to note how largely and widely the plan has been approved by the security holders of all affected classes. The holders of over 81% of the aggregate principal of all affected securities have affirmatively voted assent to the plan. Less than 1% have affirmatively dissented. Of the whole number of individual holders (less than 80,000), 39,738 have voted for the plan and only 103 against it, a percentage of over 99% for the plan and less than one-third of 1% against the plan, of those voting on it.¹² The percentages of those assents to the plan by holders of the several affected classes range from 86% to over 67%, excluding the R. F. C. as holder of the securities pledged as collateral for its loan. It has fully assented to the plan. The only intervenors in this case as objectors to the plan are listed in the margin.¹³"

Footnote 10 just referred to is as follows:

"There are only a few intervenors in this case who oppose the plan either in toto, or in the alternative

¹² It is interesting to note that even in thus stating the facts, the Court below emphasized the percentage in principal amount that had accepted and the principal amount that had *actively* dissented. It is of more than passing interest to note that these cited statistics affirmatively show that *less than one half of all the B. & O. bondholders as individuals* (as distinguished from principal amounts held) actually consented to the Plan. It is also a well known fact that most non voters are actual dissenters who merely lack the inclination, time or money to become active objectors in a huge reorganization case.

suggest modification. They are (1) George H. Phillips, the holder of an unspecified number of Convertible Bonds; (2) Jane Crozier, Roberta Giesecke and Harriet M. Ackert, holders of \$5,000 Refunding 5's due 1996, and \$1500 1st. Mtge. 5's due 1948; (3) Alfred M. Darlow, a former employe of the B and O whose petition for intervention states (without other proof) that he is the holder of \$37,000 par value of various issues of the 1st. Mtge. Bonds, and Refunding 5's; (4) Charles M. Mervin, the holder of an unspecified number of Refundings and (5) Randolph Phillips, the holder of one-third interest in \$100,000 par value of Convertibles. None was represented or participated in the hearing except Randolph Phillips (pro se) and Crozier, Giesecke and Ackert, who were represented by counsel. The latter did not oppose the plan as a whole but do suggest certain modifications which will be later noticed."

Lack of opposition is again referred to by the Court in its Footnote 21 at 63 *F. Supp.*, l. c. 562.

Footnote 27 on page 565 probably goes to the extreme in showing the influence on the Court of these factors which, by specific injunction of the Act, are not to be considered. That footnote reads as follows:

"Petitioner's Exhibits Nos. 101, 102. Counsel for the Petitioners has filed with its brief a list of about 150 banks, insurance companies and other institutions holder over \$10,000 par value of the Convertibles which have affirmatively assented to the plan. This was compiled from petitioner's Ex. 100, which includes all the written assents to the plan. It is said that many of the Convertibles are held by individuals in the European war zone and could not be reached for assents to the plan."

It can be seen from the quoted footnote that the Court even attempts to volunteer an answer as to why more of the Convertible Bondholders had not assented than did in fact.

These later footnotes are included without even giving lip service to the injunction of the Act and on the contrary have been inserted in support of matters in the text of the Opinion. These particular intervenors were referred to as "two small bondholders" (63 F. Supp., l. c. 569).¹³

At 63 F. Supp. l. c. 562 the Court observes that as to the "Refunding Bonds, there is no active opposition to the Plan as a whole or contention that it is unfair to them" and in footnotes 21 and 22 specifically notes the principal *amount* of bonds making objection. The Court also, at the same page of the Opinion, in discussing the fairness of the Plan to the several classes of creditors leans almost entirely upon the report of the Interstate Commerce Commission, saying that it "deals in much detail with the several adjustments made in the several bond issues. We think it unnecessary to repeat here what has there been carefully outlined."

At 63 F. Supp. l. c. 565 the Court notes that most "of the few intervenors" propose modifications. At l. c. 569, while considering other proposals advanced to make the Plan fair and equitable, the Court states such a Plan will entail some collision between "details" of existing indentures and their revision under the Plan, and defers to the report of the Interstate Commerce Commission.

These instances disclose only too clearly how the Court has been influenced by the number of assents, the lack of opposition, and the report of the Interstate Commerce

¹³ While none of the actual proceedings at the hearings before the Court have been brought up by these Petitioners for the reason that it is not essential to a disposition of the issue here presented, it is our understanding that the entire record has been brought up by another applicant for certiorari and by the railroad, and in this Court's perusal thereof there will undoubtedly appear many instances of statements made from the bench which will throw further light upon the general attitude of the Court toward any opposition to any feature of the plan and the tremendous impression upon the Court made by the assents.

Commission, which Commission under Chapter XV is not called upon, and did not, pass upon the fairness or equitableness of the Plan. This is not the independent consideration of that point which Congress intended the only arbiter thereof (the Court) should exercise.

The error into which the Court below fell in giving excessive and improper weight to the factors of the number of acceptances and the lack of opposition is one that was easily foreseeable at the time of the adoption of the Act. Chairman Eastman of the Interstate Commerce Commission suggested that consideration of any plan by both the Commission and the court would inevitably be affected by the fact that much time and money had already been spent on the plan before its submission to the Commission or the court and that it had at that time already been accepted by a substantial number of the creditors (See Hearings of Senate Committee on Interstate Commerce on H. R. No. 5407, 76th Cong., 1st Session (1939) 62). It was undoubtedly this feature as well as the necessity of meeting the fair and equitable standard of the *Boyd* case that prompted Congress to include in Chapter XV the statutory language referred to. One writer¹⁴ has characterized the inclusion of this provision as an "attitude of piety" and has intimated that this "pious wish" can hardly be achieved. It certainly cannot be achieved unless courts are rigorous in the enforcement of this clearly expressed provision.

That the court should be rigorous in the enforcement of this provision is clear, not alone from the wording of the Act, but from the repeated pronouncements of this Court. In the *Los Angeles Lumber Products* case, *supra*, this Court in unequivocal language pointed out that courts of bank-

¹⁴ Hubert L. Will in the University of Chicago Law Review, February, 1940, page 211.

ruptcy are not relieved of their statutory duty to appraise the fairness and equitableness of a reorganization plan by the fact that even an overwhelming majority of creditors had accepted it. This same principle was later re-announced in the *Consolidated Rock Products* case and the *Milwaukee* case, *supra*, and in *Kelley v. Everglades Drainage District*, 319 U. S. 415, 63 S. Ct. 1141, 87 L. Ed. 1485, where this Court in granting certiorari and summarily remanding the case to the District Court without argument, said (l. c. 418),

“The fact that only a very small minority of creditors have objected to the plan does not relieve the courts of the duty of appraising its fairness * * * (l. c. 419) the fact that the vast majority of security holders may have approved a plan is not the test of whether that plan satisfies the statutory standard. The former is not a substitute for the latter. They are independent.”¹⁵

Unless the Courts are constantly vigilant and strictly enforce this principle which has the unqualified backing of the Congress and this Court, it will soon deteriorate into a mere idle phrase that retains its position in the literature of the law but not in its application. It should be particularly zealously guarded in a case of this kind where the plan has its entire conception in the management (the stockholders) and has wide acceptance before the question of fairness and equitableness is even in position to be raised and passed upon by a court.

While we feel that the Court below failed to comprehend the particular issue presented by these Petitioners, we feel that their failure so to do was largely a result of their inclina-

¹⁵ For another instance where this Court used identical language to that last quoted, see *American United Mutual Life Insurance Co. v. Avon Park*, 311 U. S. 138, l. c. 148, 61 S. Ct. 157, l. c. 136, 85 L. Ed. 91, l. c. 97, 44 Am. Br. (NS) 269.

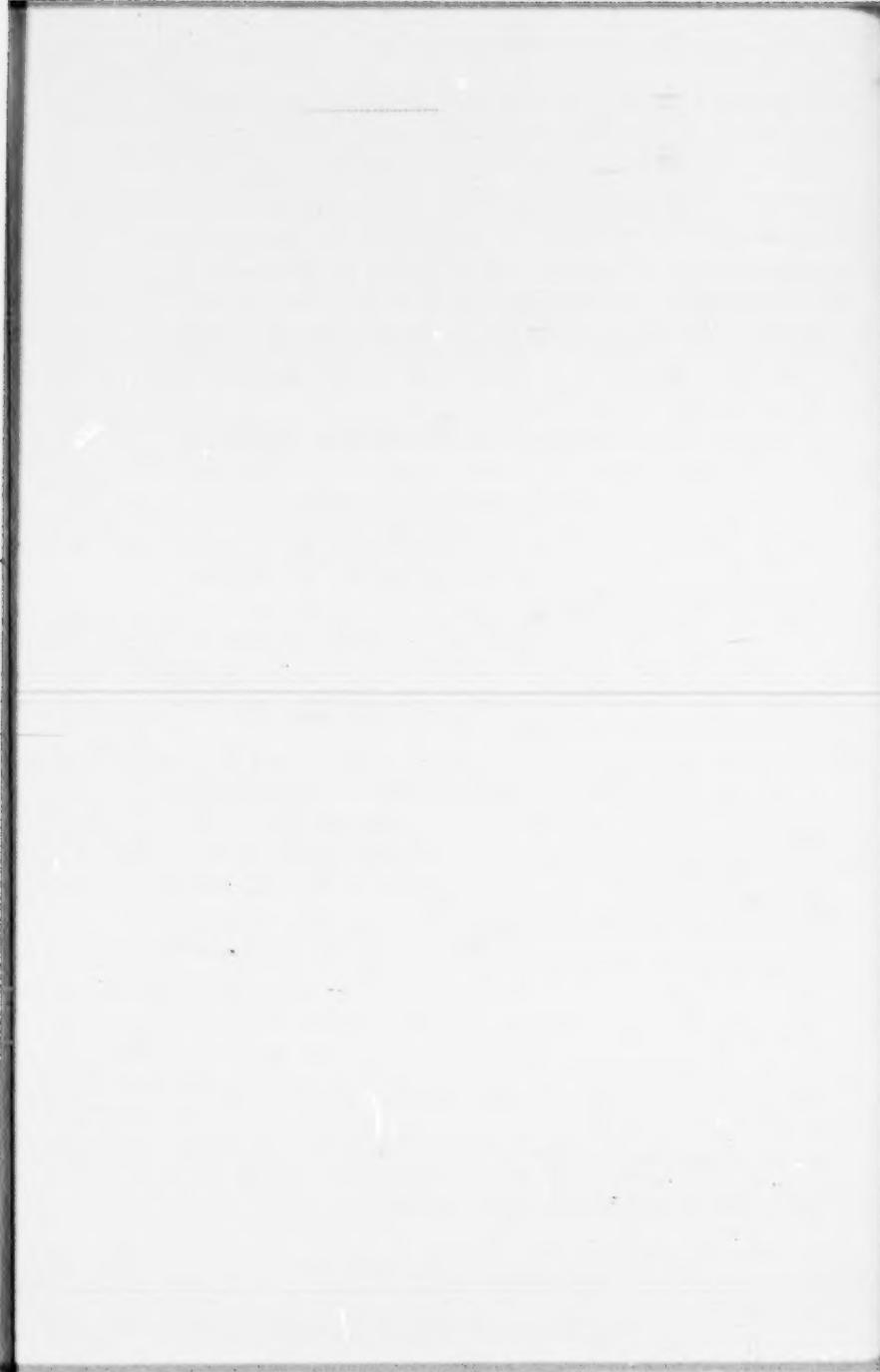
tion to dispose of many questions raised solely on the basis that the challenged provision had presumably been accepted by an overwhelming number of security holders and no one appeared in opposition except "two small bondholders"; that lip service to the rule of examining the plan independently did not in fact prevent a failure of the Court to realize the real issues embodied in this objection, so that the fundamental rights of the Refunding Bondholders were sacrificed upon the altar of expediency by the decision of the Court below.

It is respectfully submitted that the Writ of Certiorari should be issued.

HAROLD C. ACKERT,
JOHN W. GIESECKE;
Counsel for Petitioners.

ACKERT, GIESECKE & WAUGH,
Of Counsel.

(4633)



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IN THE

CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

OCTOBER TERM, 1945.

No. 1220

RANDOLPH PHILLIPS, *et al.*, Petitioners,

v.

THE BALTIMORE AND OHIO RAILROAD
COMPANY, Respondent.

No. 1221

JANE CROZIER, ROBERTA GIESECKE and
HARRIET M. ACKERT, Petitioners,

v.

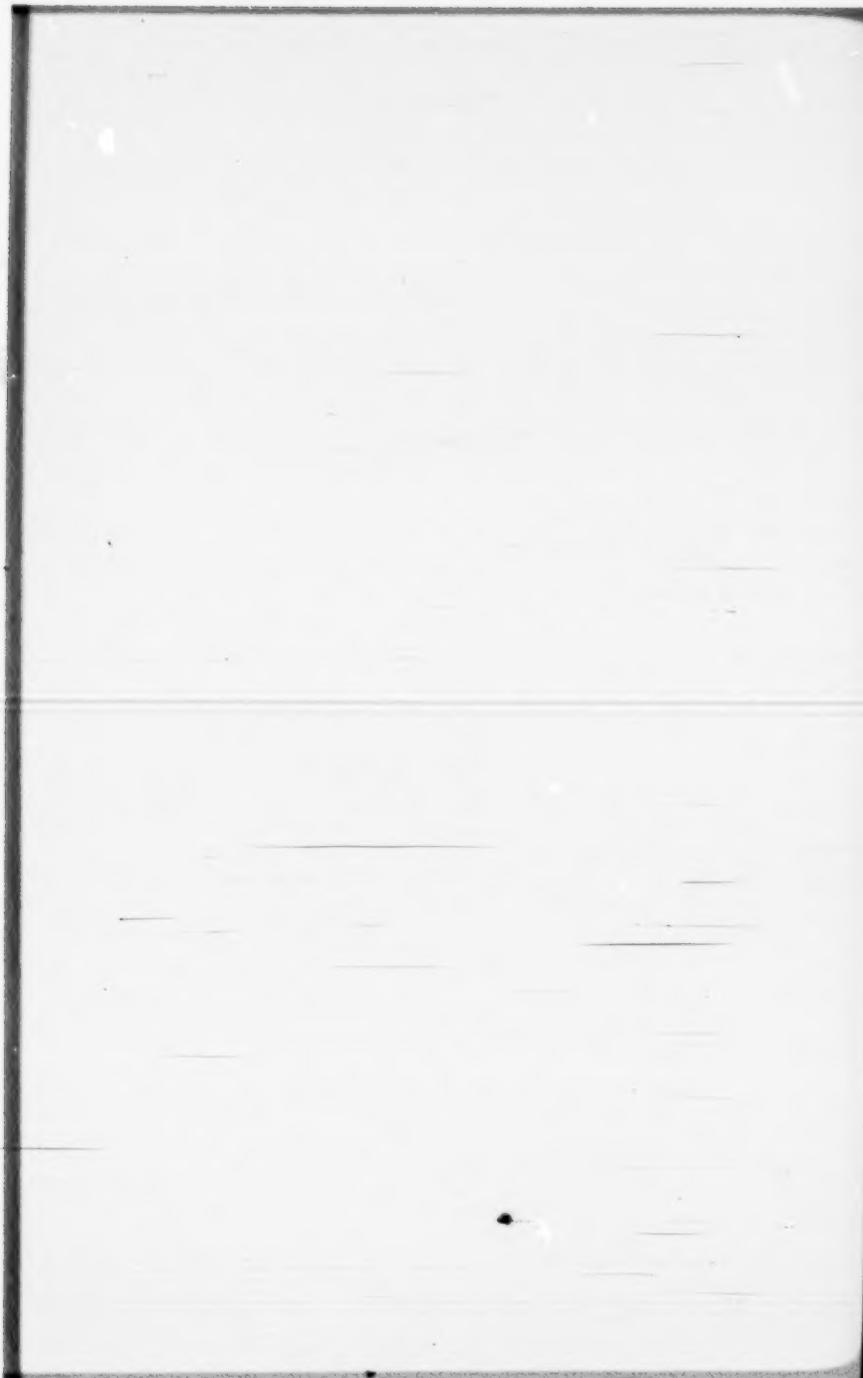
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COMPANY, Respondent.

BRIEF FOR RESPONDENT IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI

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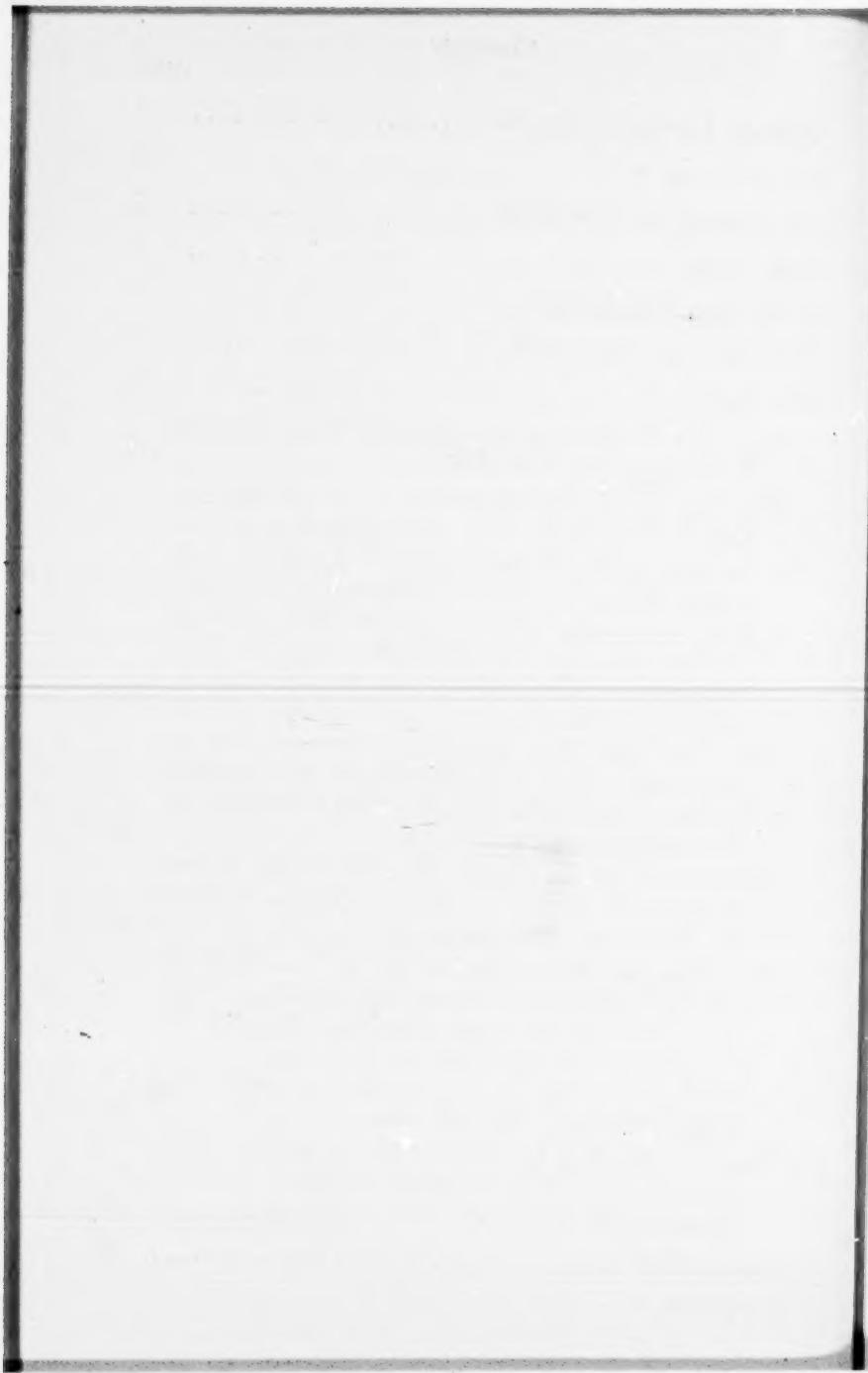
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APPENDIX A.	



IN THE
Supreme Court of the United States

OCTOBER TERM, 1945.

RANDOLPH PHILLIPS, *et al.*, Petitioners,

v.

THE BALTIMORE AND OHIO RAILROAD
COMPANY, Respondent.

JANE CROZIER, ROBERTA GIESECKE and
HARRIET M. ACKERT, Petitioners,

v.

THE BALTIMORE AND OHIO RAILROAD
COMPANY, Respondent.

} Nos. 1220-1221

**BRIEF FOR RESPONDENT IN OPPOSITION TO
PETITIONS FOR WRITS OF CERTIORARI**

Opinion Of Court Below

The opinion of the court below, a special court of three Judges in the District Court of the United States for the District of Maryland, is reported in 63 F. Supp. 542. The report of the Interstate Commerce Commission, containing the Commission's findings with respect to the Adjustment Plan approved and confirmed by the Decree of the special court, is reported in 261 ICC 51.

The contentions of Petitioner Phillips before the ICC were considered and overruled. The contentions of Petitioner Phillips and Petitioners Crozier, *et al.*, in the court below were considered and overruled.

Jurisdiction

The Decree sought to be reviewed herein was entered March 13, 1946.

The proceeding was instituted below by petition filed by Respondent under the since expired¹ Chapter XV of the Bankruptcy Act (U. S. C., Tit. 11, Secs. 1200-1255) for approval of a Plan of Adjustment (PX 1; RX 1-31²), hereinafter called the Plan. The Decree approved and confirmed the Plan.

The jurisdiction of this Court is invoked under Sec. 745 of Chapter XV of the Bankruptcy Act (U. S. C., Tit. 11, Sec. 1245).

Statement Of The Case

The Phillips petition, No. 1220, proceeds on the theory that the Plan as approved and confirmed was unnecessary and that there was no consideration moving from the stockholders to the affected creditors, in that the "plan makes no

¹See *infra*, pp. 8, 11-13.

²The record as certified to this Court by the Clerk of the court below consists of two parts, the pages of each of which are numbered consecutively beginning with 1. One part comprises all of the documentary exhibits contained in the record. To avoid confusion, we herein refer to exhibits introduced by Respondent by reference to the numbers under which they were received and the prefix PX; similarly, we refer to the exhibits introduced by the Objector (Petitioner here) by reference to the numbers under which they were received and the prefix OX. In each case reference to the exhibit number is followed by the page number of the certified record using the prefix RX. That part of the certified record which includes the pleadings, orders of the court below, and transcript of the testimony taken before the court below is referred to by page numbers with the prefix R.

alteration of the *contractual rights* of preferred and common stockholders" (Phillips petition, p. 11; italics ours). The Crozier, Giesecke and Ackert³ petition, No. 1221, does not question the necessity for the Plan. Rather it takes the position that there is no compensation whatsoever for the modifications of their bonds and suggests that the modification in the mortgage securing their bonds so as to permit the refunding or extension of prior lien bonds is not a proper modification under Chapter XV of the Bankruptcy Act.

Respondent's 1944 maturities, represented by notes, amounted at December 31, 1943 to approximately \$113,000,000 (PX 46; RX 1695). Its other near term maturities amounted to approximately \$218,000,000. Its funded debt securities were then selling at substantial discounts. The Refunding bonds, Respondent's only then available financing medium, were selling below 50 (PX 99; RX 2258)⁴. Upon arrival of the actual maturity date Respondent had been able to retire approximately \$29,000,000 principal amount of these 1944 maturities with treasury cash and the proceeds of a bank loan. Reconstruction Finance

³To avoid confusion between Petitioners and their counsel, the petition in No. 1221 is hereinafter referred to as the Crozier petition.

⁴The Interstate Commerce Commission summed up the situation in which Respondent found itself at that time, saying: "In view of these early maturities the applicant was unable to refund its outstanding notes except as part of a general readjustment of its finances" (R. 19). The Commission also observed "From the testimony it is evident that the early maturity of approximately \$144,000,000 of first-mortgage bonds, and of an additional \$74,000,000 of other first-lien bonds within 3 years thereafter has prevented the refinancing of the applicant's matured notes, and a plan of adjustment appears to be the only means of averting bankruptcy or receivership" (R. 57).

Corporation (hereinafter called RFC), which held the balance of approximately \$84,000,000, agreed to refund the same through the purchase of a new issue subject to certain conditions (PX 68; RX 1750-1). Following conferences with creditor interests, a plan of adjustment satisfactory to them and which would meet the conditions imposed by the RFC was prepared.

After securing the necessary assurances of acceptance required by Chapter XV, Respondent filed its application with the Interstate Commerce Commission for authority to issue the new securities to carry out the modifications proposed by the plan. After the hearing, the Commission, on March 12, 1945, issued its report and order (R. 11-76) authorizing the issuance of the new securities as proposed by the plan with certain minor modifications. The Commission's findings (R. 11, 63-65) are as set forth in Sec. 710(2) of the Bankruptcy Act, U.S.C., Tit. 11, Sec. 1210(2). The plan as modified by the Commission is hereinafter called the Plan.

After obtaining the necessary assents to the Plan, Respondent filed its petition for approval and confirmation. After hearing held on July 10 and 11, 1945, the court below found that the petition "complies with Chapter XV of the Bankruptcy Act, and has been filed in good faith." The court thereupon ordered that the petition be approved as properly filed and set the matter down for hearing on the merits for September 17, 1945. No petition to review the Order of July 11, 1945 (Order No. 1, R. 111) has been filed. The hearing on the merits was held on September 17-21, inclusive, and following the filing of briefs, the court below rendered its opinion on November 20, 1945, and on March 13, 1946, after hearing on the form of the Decree

and the instruments to be executed pursuant thereto, entered the Decree which Petitioners ask this Court to review. This is the fourth decision of a special three judge court under Chapter XV of the Bankruptcy Act which this Court has been requested to review on certiorari.

The Plan

The Plan, in outline, as approved and confirmed by the Decree provides for:

- (1) The refunding of \$84,000,000 odd of Respondent's 1944 maturities through the issuance of Collateral Trust bonds, maturing January 1, 1965, which RFC has agreed to buy, subject to the making of the other adjustments proposed by the Plan.
- (2) The extension of \$228,861,050 principal amount of first lien bonds maturing in 1948, 1950, 1951 and 1959 to various dates from July 1, 1975 to July 1, 1985.
- (3) The making of three-fifths of the interest on Respondent's junior mortgage bonds (Refunding and Generals maturing without being extended under the Plan from 1995 to 2000, in which Petitioners Crozier, et al., are interested), as well as the unsecured portion of the interest on the First Mortgage 5% bonds and on the Southwestern bonds, contingent as to time of payment upon earnings, but nevertheless fully cumulative.
- (4) The extension of Respondent's unsecured bonds (Convertibles, in which Petitioners Phillips, et al., are interested) from February 1, 1960 to February 1, 2010, with interest contingent as to time of payment upon earnings, but nevertheless fully cumulative.

(5) The allocation of the major portion of future earnings to a Capital Fund, a General Sinking Fund, and a Surplus Income Sinking Fund, thereby depriving Respondent's stockholders of the possibility of sharing in future net earnings to the extent of the first \$3,500,000 (approximately) per year, and then only to the extent of 25% of the remaining balance,⁵ if indeed there be any remaining balance.

(6) The freezing against dividend payments of a corporate surplus of approximately \$162,000,000, made up of approximately \$110,000,000 of appropriated and approximately \$52,000,000 of earned surplus (PX1; RX31).

(7) The cancellation of \$3,682,650 of treasury bonds.

Questions Presented

The two petitions herein present but four questions. The petition of Crozier, et al., is addressed only to the first of these questions, which are:

⁵The figure of \$3,500,000 is an absolute minimum and does not include the full amount presently payable into the Surplus Income Sinking Fund, which at the outset is 50% of annual net earnings after payment of all interest and of the fixed amounts payable into the Capital and General Sinking Funds. Cf. *infra*, p. 17, n. 10. The Surplus Income Sinking Fund payment need not exceed \$750,000 per annum when and as Respondent's annual charges for interest and guaranteed dividends are reduced below \$22,000,000. If and when such annual charges are reduced to \$20,000,000—a reduction of approximately \$5,800,000, equivalent to a debt reduction of over \$100,000,000—the provision requiring the payment into the Surplus Income Sinking Fund of an amount equal to any dividend is not operative unless and until such charges are subsequently increased to an amount in excess of that figure.

1. Both of the Petitioners claim that the decision of the court below, approving and confirming the Plan, is violative of the "strict priority" rule. Petitioner Phillips' claim on this score is in substance that the Plan provides no "compensation", or, in the words of the Statute, "fair consideration", to the holders of Convertible bonds for the adjustments therein accomplished by the Plan. Petitioner Crozier makes similar claim as to holders of Refunding bonds but argues, further, that as to such holders the court below went beyond its jurisdiction under Chapter XV in approving the provision of the Plan for "the removal of any and all existing restrictions upon the extension, renewal or refunding of bonds * * * or any other debt * * * secured by lien senior to that of the Refunding Mortgage".

2. Petitioner Phillips claims that the court below held "that the jurisdictional requirement that the petition be filed in 'good faith' meant merely that there must not be 'intentional fraud'";⁶ that RFC's refusal to extend Respondent's matured debt was collusive and amounted to bad faith; and that, hence, Respondent was unable to support the necessary allegation of its petition to the court below that it was "unable to meet its debts matured or about to mature".

3. Petitioner Phillips claims that Respondent's 1944 maturities could have been met through the application of working capital augmented by funds from the sale of system collateral securing such maturities, and that, hence, Respondent did not sustain its averment that it

⁶The court did not so hold. Cf. *infra*, pp. 20-21.

was "unable to meet its debts matured or about to mature".

4. Petitioner Phillips claims that Respondent did not sustain the burden of proving the acceptance of the Plan by affected creditors as required by Sec. 725 (2), and, further, that it induced acceptance by misrepresentation "as to the obligation of the bonds".

Summary Of Argument

1. The Petitions Present No Question Which Should Be Reviewed By This Court.

This is a proceeding, jurisdiction of which was created in the court below by an Act of Congress which has expired by its terms. No other proceeding under that expired Act is pending in any court of the United States.

The decision of the court below is in complete accord with the doctrine of "strict priority" established and reiterated by this Court. The petitions for certiorari disclose that the only "strict priority" question sought to be raised by Petitioners is whether the Plan provides "fair consideration" to the holders of Convertible and Refunding bonds. That it does is readily demonstrable.

The questions as to Respondent's "good faith", its ability to "meet its debts, matured and about to mature" and its establishment of acceptance of the Plan are largely, if not entirely, questions as to the weight and sufficiency of the evidence. Only by adroit phraseology in the Phillips petition have they been given semblance of questions of substantive law. This Court should not be asked to review evidence taken before, and considered and passed upon at first hand by, a specially constituted District Court of three

judges. Moreover, in this case the facts were largely considered and passed upon by an administrative agency charged by law with protection of the public interest which to a great extent is concerned with and will be furthered by consummation of the Plan of Adjustment approved and confirmed by the Decree of the court below.

2. The Plan Is Fair And Equitable As An Adjustment And As Such Will: (a) Afford Due Recognition To The Rights Of Each Class Of Creditors And Stockholders And Fair Consideration To Each Class Adversely Affected And (b) Will Conform To The Law Of The Land Regarding The Participation Of The Various Classes Of Creditors And Stockholders.

The Plan conforms to the "strict priority" rule laid down by this Court.

"The adjustments provided in the plan are in accord with the priorities of the several classes of claims and the extent to which they will be benefited by a financial adjustment." 261 ICC 51, 88 (R. 65).

"* * * a study of the main features of the present plan, and its particular impact on the several classes of affected securities, leads us to the conclusion that the plan as a whole is fair and equitable." 63 F. Supp. 542, 551.

The court below tested the Plan in the light of each of the statutory requirements. 63 F. Supp. 542, 550-565.

3. The Plan And The Acceptance Thereof Are In Good Faith And Were Not Made Or Procured By Any Means, Promises, Or Acts Forbidden By The Bankruptcy Act.

The court below judged Petitioner Phillips' charge of bad faith according to the standard called for by the nature of the charge and its alleged basis. The charge was that

the Plan was a "collusive management plan" (Phillips petition, p. 23). As to Respondent's averred inability to meet its debts, matured or about to mature, the charge was that it was "the result of inspiration and collusion [between the RFC and] officers and directors of the Railroad to create an only simulated or 'synthetic' financial embarrassment for the purposes of this case". 63 F. Supp. 542, 557.

As the court below quite correctly characterized it, this was a charge of "intentional fraud".⁷ 63 F. Supp. 542, 557, n. 16.

4. Respondent Was Unable To Meet Its Debts, Matured Or About To Mature, Otherwise Than By Procuring Their Extension.

Whether Respondent was able or unable to meet its debts, matured or about to mature, was largely a question of fact. As to that, certainly this Court will not permit certiorari to be used to secure a review of evidence.

That the issue of Respondent's inability to meet its debts presents no question of statutory construction is abundantly evident.

5. The Plan Has Been Accepted By Or On Behalf Of Creditors Affected Thereby Holding More Than Three-Fourths Of The Aggregate Amount Of The Claims Affected Thereby, Including At Least Three-Fifths Of The Aggregate Amount Of The Claims Of Each Affected Class.

The evidence of acceptance of the Plan was presented in the form of the original duly executed contracts of acceptance signed by the bondholders. No evidence even tending

⁷Statements in the Phillips petition that the court below limited the meaning of the words "good faith" as used in the Act to "absence of intentional fraud" are incorrect. Cf. pp. 20-21, *infra*.

to indicate invalidity of any one of the agreements of acceptance was offered for the consideration of the court below, although Petitioner Phillips was given repeated opportunities to make such offer. In any event, there is nothing involved in this question as presented by Petitioner Phillips other than a review of evidence and particularly of inferences that he would have this Court draw from the evidence.

The charge of "misrepresentation" in the procurement of the agreements of acceptance is frivolous.

6. Early Disposition Of This Cause Is In The Public Interest And In The Interest Of Each Class Of Creditors And Stockholders.

Many thousands of bondholders are waiting to exchange the bonds they now hold for the better bonds which they will receive pursuant to the Plan.

Only consummation of the Plan is delaying refunding operations, which are essential in the public interest and in the best interests of Respondent's Refunding and Convertible bondholders. To prevent, delay or make refunding operations more cumbersome, as Petitioners Crozier, et al., would do, would be contrary to their own best interests.

Argument

1. The Petitions Present No Question Which Should Be Reviewed By This Court.

A—The statute, in the application of which the court below is alleged to have "decided an important question of federal law which has not been, but should be, settled by this court," has expired by its terms.

Counsel for Petitioner Phillips tell this Court (p. 6 of their petition) that "the provisions of Chapter XV have expired except in respect of proceedings initiated before November 1, 1945." They do not tell this Court, as is the fact, that the instant proceeding is the only one initiated before November 1, 1945 in which the decree approving and confirming the Plan has not become final. Counsel for Petitioner Phillips tell this Court (p. 6 and note 7 of their petition) that "legislation to extend its provisions has passed the House of Representatives and is pending in the Senate of the United States" and that "a somewhat different bill (S. 1253, 79th Cong. 2d Sess.) * * * was reported favorably to the Senate." Counsel then suggest that final passage of S. 1253:

"* * * would remove from Section 77 and place under the new procedure—*basically similar to Chapter XV*—pending 77 proceedings of certain major railroads including the Denver and Rio Grande, The New Haven, and Missouri Pacific among others" (p. 6, n. 7 of Phillips petition; italics ours).

Finally, counsel for Petitioner Phillips tell this Court (p. 35 of their petition) that:

"A clear declaration by this Court of the necessity for unmistakable, non-colorable proof of inability to meet debts matured or about to mature is essential to proper administration of the law and to firm insistence by the courts upon the sanctity of corporate obligations in accordance with law and our constitutional system."

Counsel for Petitioner Phillips do not tell this Court that should S. 1253, as favorably reported by the Senate Com-

mittee on Interstate Commerce, become law, no issue could conceivably be raised as to whether a carrier seeking to avail itself of its benefits might or might not otherwise be "unable to meet its debts, matured or about to mature." Neither the quoted words nor others of similar purport are in the bill.

B—It is apparent from the petitions herein and from the opinion and the Decree of the court below that the decision of the court below is not in conflict with the decisions of this Court establishing the rule of strict priority.

To present a question warranting review by this Court it is not sufficient that a case involve somewhat similar facts or entail application of principles enunciated in previous decisions of this Court. Nor is it enough that this Court might possibly have decided the case differently than did the court below. It is required that the decision below be "probably in conflict with applicable decisions of this Court." Counsel for both Petitioners tell this Court that the decision below is in conflict with this Court's decision in the "strict priority" cases, but they have attempted no demonstration of their point save by quotation of broad statements of principle from several of this Court's opinions in such cases. Significantly, counsel for both Petitioners rely in the last instance on the fact as stated by counsel for Petitioner Phillips (p. 14 of their petition) that:

"Although the attention of the court below was called at length to the requirements of the *Boyd* case and cases which reiterate and apply its doctrine, *the court did not cite or refer to a single precedent * * **" (italics ours).

C—The remaining “questions” as to “good faith” and proof of the Plan’s acceptance by affected creditors involve only the weight and sufficiency of the evidence.

No argument is needed to demonstrate that there can be no warrant for the issuance of a writ of certiorari merely to review evidence or inferences drawn from it. Our analysis hereinafter of Petitioner Phillips’ unsupported accusation of fraud and collusion and his claim as to the insufficiency of the evidence of acceptance of the Plan by affected creditors leaves no doubt that his petition seeks to obscure the fact that what he is really seeking is a review by this Court of the evidence and inferences which he would draw from it.

On this score, it should be observed that although Petitioner Phillips appeared, *pro se*, both in the proceeding before the Interstate Commerce Commission and in the hearings before the court below, he offered no direct evidence save his own opinion testimony and certain statistical exhibits and the testimony of a former employee of Respondent who had resigned, as the court below noted in its opinion, “on the eve of the final hearing of this case on September 17, 1945.” That witness, who said “he did not question ‘the intrinsic soundness of the Plan’” and that he was “not questioning the good faith of any of the officers and directors of the Baltimore and Ohio who became such after the time of the 1938 Plan”, expressed the opinion that the Plan was unnecessary and therefore not in good faith, although admittedly that “was based on his own personal view” and, as the court found, “was not supported by the evidence or exhibits in the case” (63 F. Supp. 542, 557, 559).

2. The Plan Is Fair And Equitable As An Adjustment And As Such Will: (a) Afford Due Recognition To The Rights Of Each Class Of Creditors And Stockholders And Fair Consideration To Each Class Adversely Affected And (b) Will Conform To The Law Of The Land Regarding The Participation Of The Various Classes Of Creditors And Stockholders.

There is no question but that Respondent is fully solvent. The further question, whether Respondent's affairs are liquid (as Petitioner Phillips somewhat inconsistently claims) is hereinafter considered. No affected creditor's claim is scaled as to either principal or interest. Incident to the purpose of the Plan—one of its "essential features"—so to extend the maturity of Respondent's "funded debt as to prevent the grouping of maturities within a short space of time" (R. 65), the wholly unsecured Convertibles—presently not maturing until 1960—are extended to 2010, namely, after the maturity of the secured Refundings (1995-2000). Payment of the wholly unsecured interest on the Convertible bonds, amounting annually to \$2,785,770, is, like the payment of the unsecured portion of the interest on the First Mortgage 5% bonds and of the unsecured portion of the interest on the Southwestern bonds, amounting in the aggregate to \$1,237,547 per annum, made contingent upon earnings. To the extent it may not be fully paid annually it remains an absolute cumulative obligation of the Company. These are the adjustments in the rights of holders of Convertible bonds of which Petitioner Phillips complains.

The maturity of the Refunding bonds is unaffected by the Plan. Their full interest is secured, equally with their principal, by lien (subject to \$228,861,050 of prior lien bonds affected by the Plan (PX 92; RX 2240)) on Respon-

dent's property. Payment of 60% of that interest is made contingent (and cumulative) upon annual earnings, but is provided for prior to payment of *unsecured* interest. The restriction of a covenant not to extend the maturity of bonds senior in lien to the Refundings is removed in the interest of flexibility in Respondent's financial structure. This latter provision of the Plan is the adjustment in the rights of holders of Refunding bonds of which Petitioners Crozier, et al., complain.

The sole issue⁸ is whether the Plan "as an adjustment" provides "fair consideration" for the adjustments. "Fair consideration" is clearly provided through the stockholders' unqualified undertaking, which binds them for so long as the bonds affected by the Plan remain outstanding (which, as Petitioner Phillips has attempted to impress upon this Court, may be until the Twenty-first Century, in the year 2010), to devote, as an absolute minimum, the first \$3,583,-944 of Respondent's annual net earnings to the betterment of the property to which Respondent's creditors must look for payment, as well of interest on and principal of their claims, and to the retirement of debt encumbering that

⁸At the hearing before the court below, Petitioner Phillips defined the issue thus:

"* * * my position with respect to this Plan is that * * * I have no objection to a Plan of Readjustment which extends the maturities and places the *junior securities* on a contingent interest basis, provided the stockholders adequately compensate the *Convertible Bonds* for the sacrifices proposed * * *. With respect to the question of whether the Plan is fair and equitable in its treatment of Convertible Bonds, my position is that it unfairly and inequitably preserves the rights of the stockholders at the expense of the Convertible bondholders and that it *offers no compensation whatsoever* for the rights to be surrendered by the latter" (R 1434; italics ours).

property.⁹ To Petitioner Phillips, this consideration may not be "susceptible of mathematical demonstration", but to Respondent's stockholders who are contracting to deny themselves access to at least the first \$3,583,944 of annual net earnings,¹⁰ it is most definitely "susceptible of mathematical demonstration".

Likewise "susceptible of mathematical demonstration" is the consideration passing from the stockholders in their unqualified relinquishment of any right to have distributed to them as dividends any part of Respondent's admittedly substantial surplus, largely built up through the judicious management of Respondent's affairs since 1941. Both in the court below and in their petitions to this Court Petitioners have chosen to ignore this salient feature of the Plan which not only limits payment of dividends but requires as conditions precedent to such payment that interest be fully paid and that, so long as annual charges exceed \$20,000,000, additional payments (equal in amount to any dividends paid) be made into the Surplus Income Sinking Fund. That provision of the Plan further limits the source from which dividends may be paid to accumulations of the

⁹Petitioner Phillips professes to see a distinction between a Sinking Fund earmarked for a particular issue and one which although "stiff" in amount is nevertheless not earmarked so as to leave the management latitude to accomplish maximum benefits in reduction of charges. Cf. the attempt to distinguish *Delaware and H. R. R. v. Dancey*, 51 F. Supp. 763, at pp. 20-21 of the Phillips petition.

¹⁰Made up of Capital Fund \$1,093,187; General Sinking Fund \$1,740,757; Surplus Income Sinking Fund \$750,000. For the first year under the Plan the total amount is \$10,757,773.45. That amount was allocated pursuant to the Plan out of 1945 earnings, as follows: Capital Fund \$3,553,498.18; General Sinking Fund \$1,740,757; Surplus Income Sinking Fund \$5,463,-518.27. If Respondent's 1944 maturities could have been extended without the conditions imposed by their holder, that money could have been used to pay more than \$3 per share on Respondent's common stock in addition to a dividend of \$4 on its preferred stock.

excess in annual earnings, beginning with the year 1945, remaining after payment of all interest as well as all amounts required to be paid into the Capital and Sinking Funds (PX 1; RX 16).

Petitioner Phillips and Petitioners Crozier, et al., proposed in the court below that the Plan be modified so as to impose more drastic restrictions on dividend payments. Presumably they thought that if the restrictions were a little more drastic there would be "fair consideration" to the Refundings and the Convertibles. The court considered these proposed modifications very carefully, and in doing so said, in part:

"Most of the few intervenors in the case propose modifications of the plan with respect to the payment of dividends. In general they urge that more drastic restrictions should be imposed than those contained in the plan.

* * * *

* * * * These restrictions on the payment of dividends are indeed very substantial. For example, if we apply them concretely to a liberal estimate for any one year of \$45,000,000 for income available for charges, it is found that the effect of the restrictions will be to leave only \$3,000,000 as the *maximum* sum possibly available for dividends on preferred and capital stocks having an aggregate par value of over \$300,000,000. On the same estimated net income, without the plan, the sum that would have been available for dividends would be \$18,000,000.

"Various suggestions have been made for further restrictions on the payment of dividends. *We have considered all of them and have concluded that the restrictions in the plan are amply sufficient for fairness of treatment of the Railroad's creditors.*

As we have previously pointed out, if the Railroad is to remain under private management, the stockholders must have some incentive for good management and as they are one of the classes necessarily affected by the plan, it should be fair to them as well as to the creditors." (Italics in this paragraph ours.) 63 F. Supp. 542, 565-7.

Additional consideration, likewise "susceptible of mathematical demonstration", as admitted by Petitioner Phillips, lies in the provision of the Plan for the cancellation of \$3,682,650 principal amount (including \$267,000 principal amount of Convertible bonds) of bonds of issues affected by the Plan, now held in the Respondent's treasury, and which but for the Plan could be reissued.

Finally, because of the conversion privilege which attaches to both the Convertible bonds¹¹ and the Refunding bonds, and to no other class of Respondent's funded debt obligations, holders of the Convertible bonds and the Refunding bonds may at any time realize to the fullest extent on any advantage accruing to the stockholders by virtue of the Plan.

Because of the Plan, so long as the bondholders do not receive their current due, the stockholders can get nothing; whatever increase in value may ultimately accrue to the stockholders, the Convertible bondholders may share in, *pari passu*.

¹¹The privilege of conversion is extended by the Plan throughout the extended life of the Convertible bonds and this, even without the other benefits of the Plan, is consideration newly moving to them. The conversion rate is 10 shares of common stock for one \$1000 Convertible bond—par for par. Petitioner Phillips would view the conversion privilege as "compensation" if the rate were made 40 shares of common stock for one \$1000 Convertible bond (R. 1510). Obviously, then, his question is not whether there is "compensation", but, rather, "how much".

3. The Plan And The Acceptance Thereof Are In Good Faith And Were Not Made Or Procured By Any Means, Promises, Or Acts Forbidden By The Bankruptcy Act.

The conclusion of the court below that the Plan and its acceptance are in good faith and were not made or procured by any means, promises, or acts forbidden by the Bankruptcy Act, was reached on a record reflecting the most searching inquiry. The opinion below gives evidence not only of the court's meticulous consideration of every representation made to it in that regard, but also that the charge of bad faith, which is the sum and substance of the Phillips petition, is utterly baseless. In concluding a four page discussion of the subject, the court below said of Petitioner Phillips' witness:

"We have carefully considered the whole of his testimony. * * * his expressed opinion that the plan was unnecessary and therefore not in good faith, was based on his own personal view and was not supported by the evidence or exhibits in the case" (63 F. Supp. 542, 559).

In considering this aspect of the Phillips petition we cannot ignore its misstatement of the "standard" followed by the court below in considering the "good faith" question. The petition represents (p. 22) that the court below reached its decision on the erroneous "assumption that lack of good faith could be established only by a showing of 'intentional fraud' ". At page 26, the petition states that the court below was "misled by its view that 'good faith' was established unless an objector showed 'intentional fraud' ". Finally, at page 29, the petition states "the court erroneously applied to the facts the sole standard of 'intentional fraud' ".

As its opinion clearly shows, the court below was meticulous in its consideration of Petitioner Phillips' charge of "bad faith". Actually what the court below said was that "the principal attack on the plan" was the "charge that it is not proposed in good faith" (63 F. Supp. 542, 557). In a marginal note the court observed that the "good faith" requirement, appearing throughout the Bankruptcy Act and not merely in Chapter XV, had "received a judicial construction which is broader than intentional fraud". But, the court further observed, characterizing the basis for the Phillips' attack, that "in this case the phrase lack of 'good faith' is used in its primary sense of intentional fraud". And this characterization of Petitioner Phillips' attack was quite correct. For he based his charge, as the most cursory examination of the record would show, on the alleged existence of "collusion" between Respondent's officers and officers of the RFC; he alleged that there had been a secret agreement—a "gentlemen's understanding"—in 1938 to extend the 1944 maturities at the appropriate time and that RFC's subsequent refusal to extend was only "simulated"; that it refused to extend at the behest of Respondent's officers, incident to a conspiracy fraudulently to create jurisdiction of the Plan in the court below. These charges failed utterly of support.

4. Respondent Was Unable To Meet Its Debts, Matured Or About To Mature, Otherwise Than By Procuring Their Extension.

The record and the opinion of the court below establish conclusively, as a matter of fact, Respondent's inability to meet in full the \$113,000,000 of its funded debt which matured in 1944. Respondent's officers explored every avenue

of credit open to a railroad in the normal course of business, without avail. While its cash working capital was at the time in a satisfactory condition from an operating standpoint, it could not safely¹² use it to accomplish more than the approximately \$29,000,000 reduction which was effected.

The statement that "the court's finding of the Company's inability to pay debts * * * amounts merely to a finding that it was inadvisable for the Company to do so", begs the very question which the petition is designed to raise. That statement is directed to the court's refusal, in effect, to direct Respondent to sacrifice its investment in securities "of the utmost importance to the integrity of the B and O System"; holdings "highly important as the basis for important railroad operating arrangements between the B and O and the Western Maryland and Reading Railroads, and the Southern Railway" (63 F. Supp. 542, 560).

Petitioner offered no evidence even suggesting that the sale of the securities in question would have raised a sum

¹²The Phillips petition attempts to read a sinister purpose into Respondent's husbanding of its cash working capital. Such an imputation, of course, discloses lack of understanding of fundamentals of railroad finance. The wisdom of Respondent's management has already been forcibly demonstrated by current developments of which this Court must be only too well aware. The record shows that as early as the forepart of the month of March, 1946 the situation into which the national economy had developed had resulted in Respondent's cash intake of less than \$8,000,000 in an eight-day period during which its outgo was in excess of \$17,000,000 (R. 1903).

But for a reasonable cash working capital position Respondent could not have withstood the impact of the 1946 shut-downs in the automobile, steel, coal and other industries, plus a substantial retroactive wage increase for which there has been as yet no compensating increase in freight rates.

sufficient, with other funds which he charged were available, to avoid necessity for the Plan and this proceeding. As to the Reading and Western Maryland stocks, the record does show contemporary market prices. But it cannot be seriously suggested that current market prices of securities issues, of which only relatively small portions are available for public trading, can be taken to indicate the price which could be realized upon sale of substantial portions of such issues theretofore not available in the market. Or that the sale of such securities might not lead the investing public to believe that the bases for profitable operations theretofore in existence were about to be severed.

In the last analysis, as the court below pointed out, assuming the question of statutory construction to be presented, it is inconceivable that the Congress could have intended to precipitate consequences which it was the Congress' avowed purpose to avoid. This Court has clearly defined the policy governing the question. As the court below said, giving effect to that policy:

"A serious threat of the sale of these items of collateral would almost inevitably necessitate a drastic reorganization proceeding under section 77 of the Bankruptcy Act to preserve if possible the integrity of the B and O System. See *Continental Illinois Nat. Bank & Trust Co. v. Chicago, Rock Island & P. R. Co.*, 294 U.S. 648, 55 S.Ct. 595, 79 L. Ed. 1110. It is the very purpose of this present proceeding to avoid this disaster which would certainly cause great loss to the holders of securities affected by the present plan.

"Looking at the broad and beneficial purpose of Chapter XV, we think the condition therein that the Railroad must show its inability to pay its debts as

they mature should not be so narrowly and strictly construed as to deny approval of the petition in this case on the possibility that the R. C. F. [sic.] could realize on its loan by sale of collateral which might so seriously affect the integrity of the B and O System as a going concern. * * * This purpose would be defeated if such a railroad could not take advantage of the Act without disposing of collateral that would greatly impair its usefulness and efficiency as a going concern" (63 F. Supp. 542, 560).

5. The Plan Has Been Accepted By Or On Behalf Of Creditors Affected Thereby Holding More Than Three-Fourths Of The Aggregate Amount Of The Claims Affected Thereby, Including At Least Three-Fifths Of The Aggregate Amount Of The Claims Of Each Affected Class.

Evidence of due acceptance of the Plan was presented to the court below in the only way in which, due regard for the rules of evidence being had, it could properly be presented. Petitioner's Exhibit 100, offered and received in the court below, consists of approximately 39,000 individual agreements to accept the Plan, each duly executed by or on behalf of a holder of bonds of one or more of the issues affected by the Plan. The original agreements, not copies, have been sent to and are now in the office of the Clerk of this Court by order of the court below.

No offer of evidence tending to prove the invalidity of any one of such agreements was made (despite numerous opportunities accorded Petitioner Phillips in the course of the 5-day hearing on the merits) until the hearing on the form of the Decree—six months after the conclusion of the hearing on the merits of the Plan, and four months after the opinion of the court below was filed. That offer is quite properly characterized in the footnote to page 1 of the Phillips petition as an offer of proof of "representa-

tion". That Petitioner Phillips may be "attorney-in-fact" for the owners of certain bonds affected by the Plan—a fact not proven of record in this proceeding¹³—is completely immaterial to the question of the weight and sufficiency of Respondent's evidence of acceptance of the Plan as required by the Statute.

What the record shows, and the court below quite properly decided this issue on the evidence before it, is that the Plan was accepted by 99.74% of the affected creditors acting on it. Those creditors held 99.90% of the voted claims. (PX102; RX 2262)

¹³The court below found with respect to the participation, solicitation, and alleged representation of others by Randolph Phillips:

"Prior to said hearing [September 17-21, 1945] and on April 17, 1945, Randolph Phillips, who participated in person at said hearing as the owner of a one-third beneficial interest in \$100,000 principal amount of said Convertible bonds (Class 8), became registered as the owner of a \$1,000 principal amount Convertible bond (Class 8). Thereafter by communications dated April 19, 1945, May 28, 1945, and August 1, 1945, all addressed and circulated to the holders of said Convertible bonds, Randolph Phillips advised such holders not to accept the Plan and solicited from such holders (a) written authorizations to represent them in connection with the Plan, (b) written revocations of assents to and acceptances of the Plan, and (c) writings imposing conditions on assents to and acceptances of the Plan. No such authorizations, revocations, or writings were offered in evidence at said hearing. Evidence purporting to show that Randolph Phillips was possessed of authorizations to represent \$2,400,000 of convertible bonds (Class 8) was offered by him at the hearing set to consider objections to the decree and supplemental indentures held on March 12, 1946; but the evidence was rejected as coming too late since full opportunity to offer such evidence had been afforded to all parties at the hearing held September 17 to September 21, 1945" (Decree, Article I(6); R. 1945-6, cf. R. 1943).

The charge of "misrepresentation" in the procurement of the agreements of acceptance is frivolous. Solicitation of the bondholders was necessarily carried forward in accordance with applicable rules promulgated by the Securities and Exchange Commission and solicitation material was, of course, reviewed by the Securities and Exchange Commission currently. That Commission is not complaining.

6. Early Disposition Of This Cause Is In The Public Interest And In The Interest Of Each Class Of Respondent's Creditors And Stockholders.

Many thousands of bondholders are waiting to exchange the bonds they now hold for the better bonds which they will receive, pursuant to the Plan, to evidence the modifications approved by the Decree.

In its "no compensation" argument the Phillips petition attempts to refute our assertion that the Plan offered each affected bondholder a better bond than that he held, and to create the illusion that the Decree is violative of the "strict priority" rule. The Phillips petition attempts this by referring to the bonds offered in exchange as "inferior securities" (p. 14), and states that "at the very least, the plan destroys the strategic position of the Convertibles" (p. 17).

The fact is that recognized financial services have rated the new bonds as "better bonds" than those for which they were offered in exchange (Cf. PX 98; RX 2254 and PX98A; RX2256). And such improved rating necessarily enhances their market value (R. 720-725). In the course of the hearing on the merits of the Plan, Petitioner Phillips attempted to support his suggestion that the Convertible bondholders would lose their "strategic position"

by a statistical exhibit purporting to illustrate the effect of the Plan on the interest "coverage" of the Convertible bonds. That statistical statement (OX 25; RX 3478) proceeded on the assumption that the Company's annual earnings experience of the twenty-four year period 1921-1944 would be repeated in the twenty-four year period 1945-1968. Of course, the statement as presented showed an impairment in the earnings coverage position of the Convertible bonds because it contemplated payments of substantial amounts into the Capital and Sinking Funds ahead of the payment of Convertible bond interest, but assumed the complete sterilization of those funds and ignored the necessary effect of such payments. That, in fact, the Capital and Sinking Funds will provide the complete salvation of the Convertible bonds is demonstrated in Appendix A hereto. Appendix A further assumes that during the putative twenty-four year period Respondent's stockholders would receive the maximum dividends distributable to them under the restrictive provisions of the Plan. Appendix A demonstrates conclusively that even on Petitioner Phillips' theory, the Convertible bondholders are, through the Plan, offered "superior securities" and a bulwark for their "strategic position".

In conclusion, it must be observed that the net effect of Petitioners' efforts to hinder and delay consummation of the Plan which is clearly in the best interests of each class of Respondent's creditors, can only be productive of detriment to those creditors. Only consummation of the Plan stands in the way of refunding operations,¹⁴ otherwise im-

¹⁴The Convertible and Refunding bondholders are especially interested, and immediately so, in the Company's ability successfully to perform refunding operations, in any event. But for the Plan, the maturity of approximately \$144,000,000 of First Mortgage bonds would now be a scant two years in the future.

mediately available. By such operations alone, Respondent's interest charges can be reduced to a figure well within its historical low limit of earnings. Such refunding operations would further increase the interest coverage of all Respondent's funded debt obligations and redound particularly to the benefit of the junior mortgage debt (the Refunding bonds) and the unsecured Convertible bonds.

Conclusion

It is clear that neither of the petitions has stated a case for review by this Court, and both should, therefore, be denied.

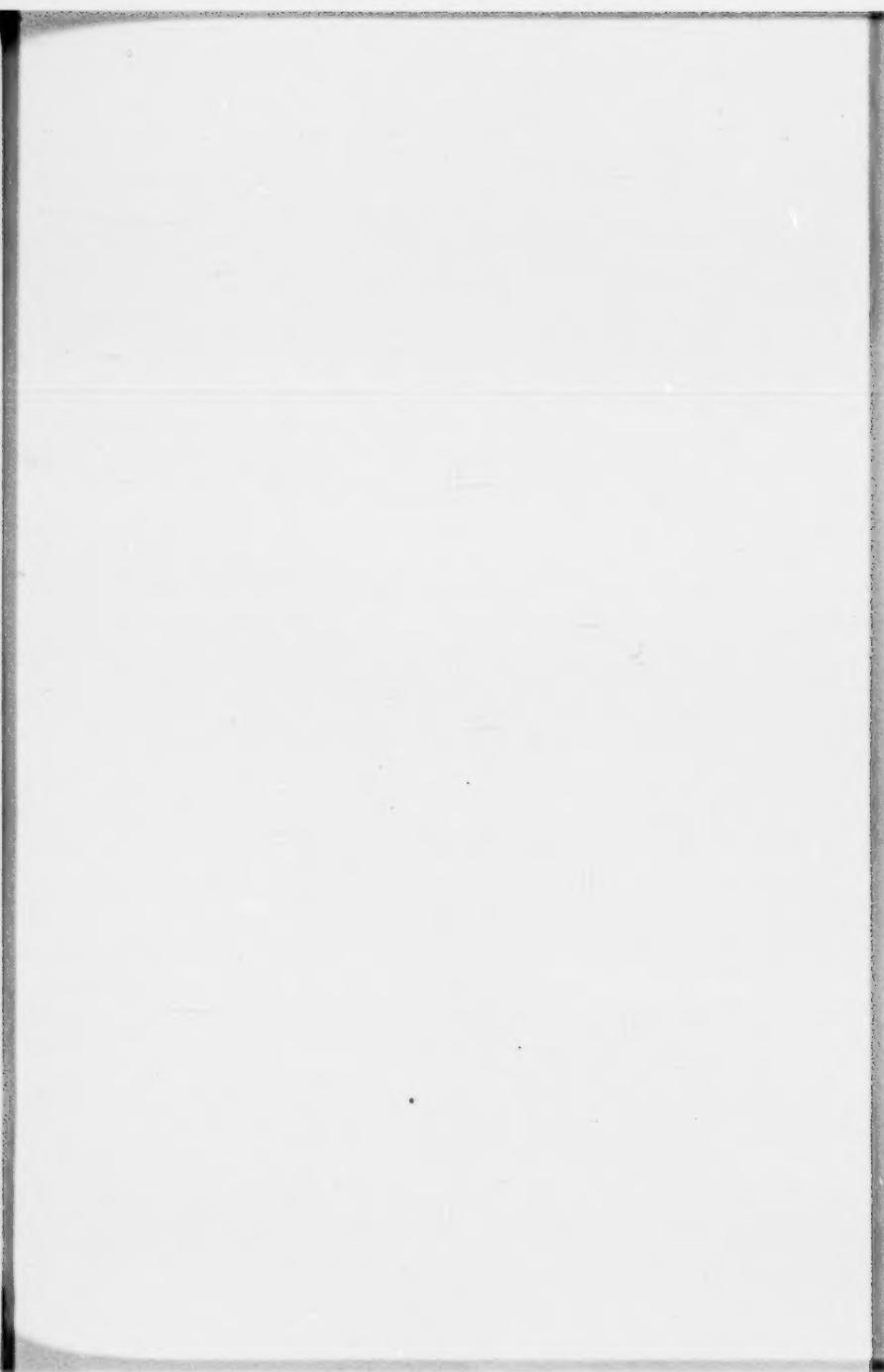
Respectfully submitted,

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Dated May 24, 1946



Number of Times I

	<u>1921</u>	<u>1922</u>	<u>1923</u>	<u>1924</u>	<u>1925</u>	<u>1926</u>
Income Available For Fixed Charges.....	\$30.94	\$29.81	\$50.79	\$45.64	\$51.42	\$59.63
Fixed Interest.....	\$17.57	\$17.49	\$17.42	\$16.88	\$16.42	\$15.81
Other Fixed Charges.....	1.24	1.07	1.05	1.17	1.09	1.31
Capital Fund.....	1.57	1.68	3.22	2.26	2.60	3.02
Sinking Fund.....	1.75	1.75	1.75	1.75	1.75	1.75
Secured Contingent Interest.....	3.86	3.85	3.84	3.71	3.61	3.46
Unsecured Contingent Interest.....	4.02	4.01	4.01	3.93	3.87	3.79
Total Charges.....	<u>\$30.01</u>	<u>\$29.85</u>	<u>\$31.29</u>	<u>\$29.70</u>	<u>\$29.34</u>	<u>\$29.14</u>
Number of Times Total Charges were Earned	1.03	1.00	1.62	1.54	1.75	2.05
<i>Cf. Number of Times Total Charges were Earned as Shown on OX 25.....</i>	(1.03)	(.99)	(1.60)	(1.50)	(1.66)	(1.90)
Sinking Fund, Paragraph (6) Article III.....	\$.46	....	\$ 9.75	\$ 7.97	\$11.04	\$15.25
Remaining Available Income for Other Corporate Purposes, including Dividends, Paragraph 7, Article III.....	\$.46	....	\$ 9.75	\$ 7.97	\$11.04	\$15.25
Maximum Amount Payable as Dividends, Article VII .....	....	....	\$ 4.87	\$ 3.98	\$ 5.52	\$ 7.62
Additional Sinking Fund Payments,						
Article VII .....	....	....	\$ 4.88	\$ 3.99	\$ 5.52	\$ 7.63
Total Sinking Fund Payments.....	\$ 2.21	\$ 1.75	\$16.38	\$13.71	\$18.31	\$24.63

NOTE: In this restatement OX 25 is varied only to give effect to application of the Sinking Fund made, in each year, the maximum dividend payment permissible under Article VII of the Plan and that is, without discount or premium. Monies paid into the Sinking Fund under paragraph number and/or series remaining outstanding at the close of the preceding year, subject to the limitations imposed in 1929, because in no year after 1929 would System charges for interest and guaranteed dividends have exceeded the maximum amount payable as dividends.

The figures shown hereon do not, and cannot, reflect the cumulative effect of the increase in Art. III (7), for capital improvements above and beyond the Capital Fund, and for debt reduction.

APPENDIX A

RESTATEMENT OF OX 25; RX 3478

THE BALTIMORE AND OHIO RAILROAD COMPANY

Times Interest on Convertible 4½% Bonds, due 1960, Would Be Earned Under 1944 Plan
(Money Figures stated in Millions of Dollars)

1926	1927	1928	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938
59.63	\$54.89	\$59.28	\$60.05	\$53.34	\$35.58	\$26.79	\$33.65	\$28.52	\$29.44	\$37.43	\$31.46	\$31.46
15.81	\$14.98	\$14.25	\$13.62	\$12.96	\$12.88	\$12.79	\$12.70	\$12.62	\$12.53	\$12.45	\$12.35	\$12.35
1.31	1.84	1.27	1.73	1.02	1.20	1.22	1.19	1.20	1.53	1.82	1.43	1.43
3.02	2.72	2.48	2.72	1.69	1.09	1.09	1.10	1.09	1.09	1.09	1.09	1.09
1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
3.46	3.26	3.08	2.92	2.77	2.76	2.75	2.74	2.72	2.71	2.70	2.69	2.69
3.79	3.70	3.61	3.55	3.49	3.48	3.46	3.45	3.44	3.43	3.41	3.40	3.40
29.14	\$28.25	\$26.44	\$26.29	\$23.68	\$23.16	\$23.06	\$22.93	\$22.82	\$23.04	\$23.22	\$22.71	\$22.71
2.05	1.94	2.24	2.28	2.25	1.54	1.16	1.47	1.25	1.28	1.61	1.39	1.39
(1.90)	(1.70)	(1.90)	(1.84)	(1.79)	(1.16)	(.87)	(1.09)	(.97)	(.98)	(1.34)	(1.06)	(1.06)
15.25	\$13.32	\$.75	\$.75	\$.75	\$.75	\$.75	\$.75	\$.75	\$.75	\$.75	\$.75	\$.75
15.25	\$13.32	\$32.09	\$33.00	\$28.91	\$11.67	\$ 2.98	\$ 9.97	\$ 4.94	\$ 5.65	\$13.46	\$ 8.00	\$ 8.00
7.62	\$ 6.66	\$16.04	\$16.50									
7.63	\$ 6.66	\$16.05	\$16.50									
24.63	\$21.73	\$18.55	\$19.00	\$ 2.50	\$ 2.50	\$ 2.50	\$ 2.50	\$ 2.50	\$ 2.50	\$ 2.50	\$ 2.50	\$ 2.50

Sinking Fund payments provided for in paragraphs numbered (2) and (6) of Article III of the Plan and in Article VI of the Plan and that, consequently, Sinking Fund payments would have been substantially increased. All retirements of bonds numbered (6), in each year, have been prorated among the bonds of each of the several issues and/or series of bonds imposed by the seventh paragraph of Article VI in respect to the Convertible Bonds. No figures are included which ends have exceeded \$20,000,000. See Article VII of the Plan.

Increase in earning power that must result from use of the Capital Fund for essential improvements, and use of monies so released above and beyond the Sinking Fund, and the consequent ability to refinance at lower rates of interest.

Plan

1936	1937	1938	1939	1940	1941	1942	1943	1944
\$37.43	\$31.46	\$19.06	\$30.17	\$37.18	\$52.60	\$76.54	\$58.77	\$48.27
\$12.45	\$12.35	\$12.27	\$12.21	\$12.12	\$12.03	\$11.94	\$11.85	\$11.76
1.82	1.43	1.39	1.29	1.38	1.22	1.15	1.46	1.59
1.09	1.09	1.09	1.09	1.09	1.78	3.75	5.05	5.77
1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
2.70	2.69	2.68	2.67	2.66	2.65	2.64	2.63	2.62
3.41	3.40	3.39	3.38	3.36	3.35	3.34	3.32	3.31
\$23.22	\$22.71	\$22.57	\$22.39	\$22.36	\$22.78	\$24.57	\$26.06	\$26.80
1.61	1.39	.84	1.35	1.66	2.31	3.12	2.25	1.80
(1.34)	(1.06)	(.63)	(1.02)	(1.25)	(1.73)			
\$.75	\$.75	.....	\$ .75	\$.75	\$.75	\$.75	\$.75	\$.75
\$13.46	\$ 8.00	.....	\$ 7.03	\$14.06	\$29.07	\$51.23	\$31.96	\$20.72
\$ 2.50	\$ 2.50	\$ 1.75	\$ 2.50	\$ 2.50	\$ 2.50	\$ 2.50	\$ 2.50	\$ 2.50

the Plan and in Article VII thereof, it being assumed that Petitioner would have
 1. All retirements through the Sinking Fund are assumed to have been at par—
 issues and/or series in proportion to the principal amount of each such issue
 so figures are included in the two lines preceding the last for any year subsequent to

ments, and use of money available for "any other proper corporate purpose" (Plan,
 lower rates of interest.

NO. 1220.

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1945.

RANDOLPH PHILLIPS, ET AL., *Petitioners*,

v.

THE BALTIMORE AND OHIO RAILROAD COMPANY.

On Petition for a Writ of Certiorari to the United States
District Court for the District of Maryland.

**MEMORANDUM OF RECONSTRUCTION FINANCE
CORPORATION.**

JOHN D. GOODLOE,
General Counsel.

W. MEADE FLETCHER,
Chief Railroad Counsel.

RECONSTRUCTION FINANCE CORPORATION.

May 28, 1946.



IN THE

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On Petition for a Writ of Certiorari to the United States
District Court for the District of Maryland.

**MEMORANDUM OF RECONSTRUCTION FINANCE
CORPORATION.**

This memorandum of Reconstruction Finance Corporation is submitted because of certain statements contained in the above mentioned petition for writ of certiorari filed in behalf of Randolph Phillips, et al., (hereinafter referred to as the Phillips petition).

I. INTRODUCTORY STATEMENT.

Reconstruction Finance Corporation (hereinafter referred to as the RFC), pursuant to the provisions of Section 5 of the Reconstruction Finance Corporation Act, 47

Stat., Chap. 8, P. 5, made certain loans to The Baltimore and Ohio Railroad Company (hereinafter referred to as the B. & O.), which loans were disbursed during the period from April 8, 1932 to March 29, 1938, both dates inclusive.

The RFC holds collaterally secured notes of the B. & O. in an aggregate principal amount in excess of \$80,000,000, of which notes for \$13,490,000 principal amount matured on August 1, 1944, and the balance matured on November 8, 1944.

On February 15, 1944, the B. & O. requested the RFC to extend the B. & O.'s indebtedness represented by said \$13,490,000 principal amount of notes maturing on August 1, 1944 and also, in order to enable the B. & O. to meet in full the balance of August 1, 1944, notes which were in the hands of the public, to either (a) make an additional loan of not to exceed \$6,500,000 to the B. & O.; or (b) permit the B. & O. to obtain a bank loan of not to exceed \$6,500,000.

By letter dated February 19, 1944, the RFC advised the B. & O. that, subject to certain conditions, it was willing to make an additional loan to the B. & O. of not to exceed \$6,500,000 and to extend its existing loan to the B. & O. evidenced by the \$13,490,000 principal amount of notes maturing August 1, 1944. The RFC letter of February 19 provided, among other things, that "said additional loan and said extended loan shall mature on such date or dates as may be hereafter determined." There was also a provision in RFC's letter of February 19, 1944 that, prior to the disbursement of the proposed additional loan, the Company might obtain, through private channels, a temporary loan maturing not later than February 15, 1945.

On March 14, 1944, the B. & O. requested the RFC to extend the loans in the then principal amount of \$71,073,381 maturing November 8, 1944, and to consolidate said loans with the loan evidenced by the \$13,490,000 principal amount of notes maturing August 1, 1944 and to treat all such loans "as one extended loan."

By letter dated April 6, 1944 the RFC advised the B. & O. that it was agreeable "that the proposed additional loan, the proposed extended loan of \$13,490,000, and all indebtedness of your Company to this Corporation maturing on November 8, 1944 shall be treated as one consolidated debt" and expressed its willingness that the consolidated loan should mature on January 15, 1955, subject to the conditions, among other things, (1) that the B. & O. should extend, to a date not earlier than January 15, 1955, its debt to others (other than equipment obligations) maturing during the period between November 8, 1944 and January 15, 1955; (2) that the B. & O. should make such modifications of its interest and other charges on its outstanding securities as should be satisfactory to the RFC; and (3) that the B. & O. should agree to establish and carry out a debt retirement program which should be effective at least until January 15, 1955 and also should be satisfactory to the RFC.

With respect to condition (1) set forth in said letter, it should be noted (a) that it has always been the general practice of the RFC, in making railroad loans or in extending existing loans, to require that such loans by it should not mature subsequent to the maturity dates of important bond issues of the borrower, and (b) that the RFC realized that the B. & O. was faced with large and poorly spaced maturities, between July 1, 1948 and November 1, 1951, both dates inclusive, of publicly held bonds in the aggregate principal amount of \$218,832,350. These bonds consist of several issues but are all "first lien bonds", the liens of which are in general superior to the lien of the \$102,388,750 principal amount of the B. & O.'s Refunding and General Mortgage Bonds which constitute the largest principal item of collateral securing the RFC's loans to the B. & O.

With respect to condition (2) in the letter dated April 6, 1944—the condition which required that the B. & O. should make such modifications of its interest and other charges on its outstanding securities as should be satis-

factory to the RFC—it should be remembered that the RFC was entirely cognizant of the fact that the B. & O. had failed to earn enough to cover its fixed charges in each of the following years: 1932, 1934, 1935, 1937, 1938 and 1939. It was likewise cognizant of the fact that the interest modifications established by the B. & O.'s Adjustment Plan of 1938, which made certain interest charges contingent, would expire in 1946.

In connection with condition (3) in the letter dated April 6, 1944—the condition which required the establishment of a debt retirement program—it should be remembered that the Interstate Commerce Commission, in its annual reports, has been urging that the railroads should do everything within their power to retire their debts and also that, by 15 U. S. C. A. 605m, it is provided with respect to RFC loans to railroads that:

" . . . the Corporation may require as a condition of making any such loan or renewal or extension for a period longer than 5 years, or purchasing any such obligation maturing later than 5 years from the date of purchase by the Corporation, that such arrangements be made for the reduction or amortization of the indebtedness of the railroad, either in whole or in part, as may be approved by the Corporation after the prior approval of the Interstate Commerce Commission."

With a letter dated September 13, 1944, the B. & O. (which had meanwhile advised the RFC that it would not need the proposed additional loan from RFC referred to in RFC's said letters of February 19, 1944 and April 6, 1944) submitted to the RFC a draft of an adjustment plan and inquired whether "upon the confirmation of a plan along the lines of the enclosed draft, your Corporation will consider that the conditions specified in your letter of April 6, 1944, will have been met?" This letter requested that RFC extend its B. & O. loans to mature in 1965 instead of 1955, as stated in RFC's letter of April 6, 1944.

By letter dated September 19, 1944, the RFC advised the B. & O. that the RFC would purchase an issue of Collateral Trust 4% Notes maturing January 1, 1965 of a principal amount equal to the aggregate principal amount, as of the date of purchase thereof, of the B. & O.'s August 1, 1944, and November 8, 1944, notes held by the RFC, such Collateral Trust Notes to be secured by the pledge of and to be a first lien upon all of the collateral securing the August 1, 1944 and November 8, 1944 notes of the B. & O. held by the RFC. In considering RFC's letter, it should be borne in mind that the August 1, 1944 and November 8, 1944 notes then and now held by RFC are neither in form nor in denominations nor otherwise suitable for distribution to private investors. The proposed Collateral Trust obligations referred to in RFC's letter would be issued under an indenture (under which there would be a trustee who would hold the collateral) which would provide for their issuance in such denominations as to make them readily salable to private investors.

The B. & O.'s letter of October 14, 1944 to the RFC contained a copy of the B. & O.'s plan put in form for final printing. The B. & O. in that letter requested that the RFC advise whether it would accept the treatment proposed in the plan and whether, subject to all necessary approvals of the Interstate Commerce Commission, it would purchase, at par and accrued interest, the issue of Collateral Trust Bonds provided in the plan. The references in the B. & O.'s letter to "Collateral Trust Bonds" were in accordance with the conditions as to the proposed "Collateral Trust Notes" set forth in RFC's letter of September 19, 1944.

On October 18, 1944 the RFC advised the B. & O. that it would accept the treatment proposed in the plan for the B. & O.'s August 1 and November 8, 1944 notes held by the RFC and would, "subject to all necessary approvals by the Interstate Commerce Commission, purchase at par and accrued interest the Collateral Trust Bonds provided in the Plan for the purpose of refunding the said notes held by

this Corporation, provided the Plan is finally approved and confirmed."

The B. & O.'s said Adjustment Plan, dated September 20, 1944, was twice considered by the Interstate Commerce Commission, in 261 I. C. C. 51 (1945) and 261 I. C. C. 211 (1945) and was later approved by the special three-judge District Court pursuant to the provisions of Chapter XV of the Bankruptcy Act, the opinion of said Court being reported in 63 F. Supp. 542 (1945).

II. STATEMENT OF RFC's POSITION AND ITS REASON FOR FILING THIS MEMORANDUM.

RFC did not intervene as a party in the proceedings either before the Interstate Commerce Commission or the Special Court.

The sole reason for RFC's submission of this memorandum is that the Phillips petition contains certain statements imputing motives to RFC which are contrary to fact. The RFC deems it its duty, as an agency of the Government, to inform this Court that certain statements, implications, and innuendoes with respect to RFC in that petition are baseless and without foundation in fact.

In the Phillips petition it is contended, among other things, that the B. & O. has not proceeded in good faith and the statement is made (Pet. p. 28) that the RFC has been "a willing partner" of the B. & O. There are also references to "the collusive management plan" (Pet. p. 23) and to "collusive petitions" (Pet. p. 29).

The language of the Phillips petition referred to in the next preceding paragraph of this memorandum seems designed to imply that the decisions of the RFC with respect to the 1944 maturities of the B. & O. notes held by it were arrived at, not in the interest of the RFC, but in the interest of the B. & O.

Since these implications in the Phillips petition are incorrect and since the RFC is an agency of the Government charged with administering the public funds lent by it in

the exercise of its statutory powers, the RFC believes it appropriate to file this memorandum so that this Court may be informed as to the reasons which guided the RFC with respect to its B. & O. notes maturing in 1944 and the reasons why the RFC believes that its actions have been in accordance with its duties and responsibilities.

III. GENERAL STATEMENT.

Under the provisions of Section 5 of the Reconstruction Finance Corporation Act, the RFC is empowered to make loans to railroads, upon full and adequate security, when, in its opinion, funds are not available on reasonable terms through private channels.

During the fourteen years of its existence the RFC, in the exercise of its statutory power, has disbursed upward of One Billion Dollars in loans to railroads and the purchase of railroad obligations. At the present time, it has recovered more than 83% of the total so advanced. The B. & O. indebtedness represents almost 50% of the amount of RFC railroad loans presently outstanding.

This successful record of the RFC in recovering its railroad loans is a sufficient answer to the implication, apparently intended by the statement on p. 28 of the Phillips petition that "The RFC has never in its history foreclosed a railroad pledge or forced a railroad reorganization by refusing to extend a loan", that the RFC has been an unduly lenient creditor of railroads, heedless of its responsibility to take the necessary steps to collect payments of its loans.

The RFC has recovered its railroad loans in two ways: (a) collections from borrowers and (b) sales to private investors of the obligations evidencing its loans.

RFC desires to sell such obligations without discount below their principal amount. Private investors will purchase such obligations from the RFC on this basis only when they are satisfied that the obligations are fully secured and that the issuer of such obligations is in sound financial condition.

In accordance with this practice RFC has endeavored to have its loans to the B. & O. put in such condition that it may dispose of the same to the investing public without loss to the RFC.

A. The Conditions Imposed by the RFC in Its Letter of April 6, 1944, Were Lawful and in the Public Interest.

As we have pointed out, the RFC, in its letter of April 6, 1944 required in effect, as conditions to its consent to extend its loans to the B. & O., that the B. & O. should (1) postpone the maturities of certain of its publicly held bonds to a date not earlier than the extended date of the road's indebtedness to RFC, (2) readjust its interest and other charges and (3) establish a satisfactory debt retirement program.

The condition that the B. & O. should postpone the maturities of its publicly held bonds to a date not earlier than the maturity date of the new Collateral Trust Bonds proposed to be purchased by RFC is the same as that imposed by the RFC generally with respect to its railroad loans. It would have been contrary to sound financial policy for the RFC to extend or make a loan with a maturity date subsequent to the date of maturity of substantial amounts of publicly held bonds, the refunding of which presented a serious problem. In this connection, it should be remembered that the RFC may make loans to railroads only when, in its opinion, the needed funds are not available on reasonable terms through private channels. Since the B. & O. has had to avail itself of financial assistance from the RFC, it is reasonable to expect that, in the absence of an adjustment plan, the road would not be able to effect the refunding of its publicly held senior lien bonds maturing during the years 1948, 1950 and 1951. Accordingly, the extension of such bonds was a necessary condition to the decision of RFC to have its loan to the B. & O. mature subsequent to the present maturity dates of said bonds.

The condition that the B. & O. should adjust its interest charges was occasioned by the fact that, as known

by RFC, the B. & O. in six of the last fourteen years has failed to earn enough to cover its fixed interest charges. While the B. & O., like other railroads, has enjoyed the benefit of substantially larger earnings during the war years, it is not expected that such high earnings will continue in the future. The RFC was therefore acting as a prudent lender when it required that the B. & O. should reduce its fixed charges to an amount which could reasonably be expected to be covered by its earnings, in bad years as well as good.

In this connection, it is to be noted that the Interstate Commerce Commission has frequently pointed out that excessive fixed interest charges have constituted one of the principal stumbling blocks to the well-being of the railroads. In recognition of this fact, the RFC in 1940 prescribed as a condition to assisting the Boston and Maine Railroad with a large loan that it reduce substantially its fixed interest charges. See *Boston & Maine Railroad Reconstruction Loan*, 240 I. C. C. 499 (1940); *Boston & Maine Railroad Readjustment*, 240 I. C. C. 511 (1940).

In 1941, the RFC agreed to extend until 1955 the maturity of \$28,000,000 principal amount of bonds of The Colorado and Southern Railroad Company which it held, upon the condition, among others, that interest on the publicly held bonds of another issue of that Company maturing in 1980 should be reduced and be made partially contingent upon earnings. See *Colorado & Southern Railway Company et al Reconstruction Financing*, 252 I. C. C. 761 (1942); *Colorado & Southern Railway Company Securities*, 254 I. C. C. 47 (1942); *in re Colorado and Southern Railway Company* (U. S. District Court for the District of Colorado, 1943), CCH Bankr. L. S. Sec. 54,303.

Both the Boston and Maine and the Colorado and Southern plans of adjustment have worked out very satisfactorily and the financial condition of those roads has been substantially improved as a result of RFC's action. The \$40,000,-000 of Boston and Maine Bonds formerly owned by RFC have now been all satisfactorily disposed of, while the Colo-

rado and Southern has paid off a substantial amount of its bonds held by RFC.

As to the RFC's condition that the B. & O. should establish a satisfactory debt retirement program, it has long been recognized that railroads as a whole are heavily burdened by their large funded debt and that it is in the public interest that every effort should be made to reduce such indebtedness. In this connection, attention is called to the following extracts from Annual Reports of the Interstate Commerce Commission, as quoted by the Senate Committee on Interstate Commerce on page 21 of Senate Report No. 925, second session of the 79th Congress, which Report is entitled "Investigation of Trusteeships Under Section 77 of the Bankruptcy Act and Railroad Equity Receivingships":

"In our last annual report, we again discussed the importance of debt reduction. We suggested that the present favorable earnings be used as largely as is practicable for that purpose. We are convinced that both the public interest and the interest of carrier shareholders will in the long run be served by that policy (same)."

* * * * *

"It is gratifying to report that more and more railroads in a position to do so are voluntarily reducing or taking steps looking toward the gradual reduction of their funded debt and the burden of fixed interest charges. Some are using their surplus earnings to retire a part of their funded debt or to purchase on the open market their own outstanding securities or those of their subsidiaries which they have guaranteed."

Thus it appears that the conditions imposed by the RFC in its letter of April 6, 1944, were those of a careful lender, and also in the public interest, requiring a large and important railroad company to reduce its fixed interest charges and to establish and continue a satisfactory program of debt retirement.

B. There Has Been a Marked Increase in the Value of the Collateral Securing the RFC's Loans to the B. & O.

At one time, due to the unfavorable earning record of the B. & O., the RFC's loans to the B. & O. were undersecured, but at the present time they are excellently secured. That such is the fact is admitted on Page 27 of the Phillips petition, where it is stated:

"During this period the collateral securing the debt to the RFC of roughly \$81,000,000 increased in market or appraised value from \$70,000,000 to a total of \$162,000,000 as of December 26, 1944. At the time of the Court's opinion it conceded the collateral a value of \$172,000,000 (p. 560 of 63 F. Supp.)."

From the above quotation, it is apparent that the RFC's loans to the B. & O. are now so well secured that private capital should be interested in acquiring the same, provided that they be put in such shape that they can be distributed among members of the investing public. *They will be put in such shape*, if the Plan is consummated and they are refunded by the proposed Collateral Trust Bonds.

CONCLUSION.

We submit that the implications in the Phillips petition that RFC has been "a willing partner" of the B. & O. and that the RFC has acted "collusively" with the B. & O. are fully refuted by the fact that, as hereinbefore shown, the RFC's actions with respect to its B. & O. loans were consistent with its actions with respect to others of its important railroad loans and that such actions have been in accordance with the public interest, as defined in the annual reports of the Interstate Commerce Commission previously cited herein.

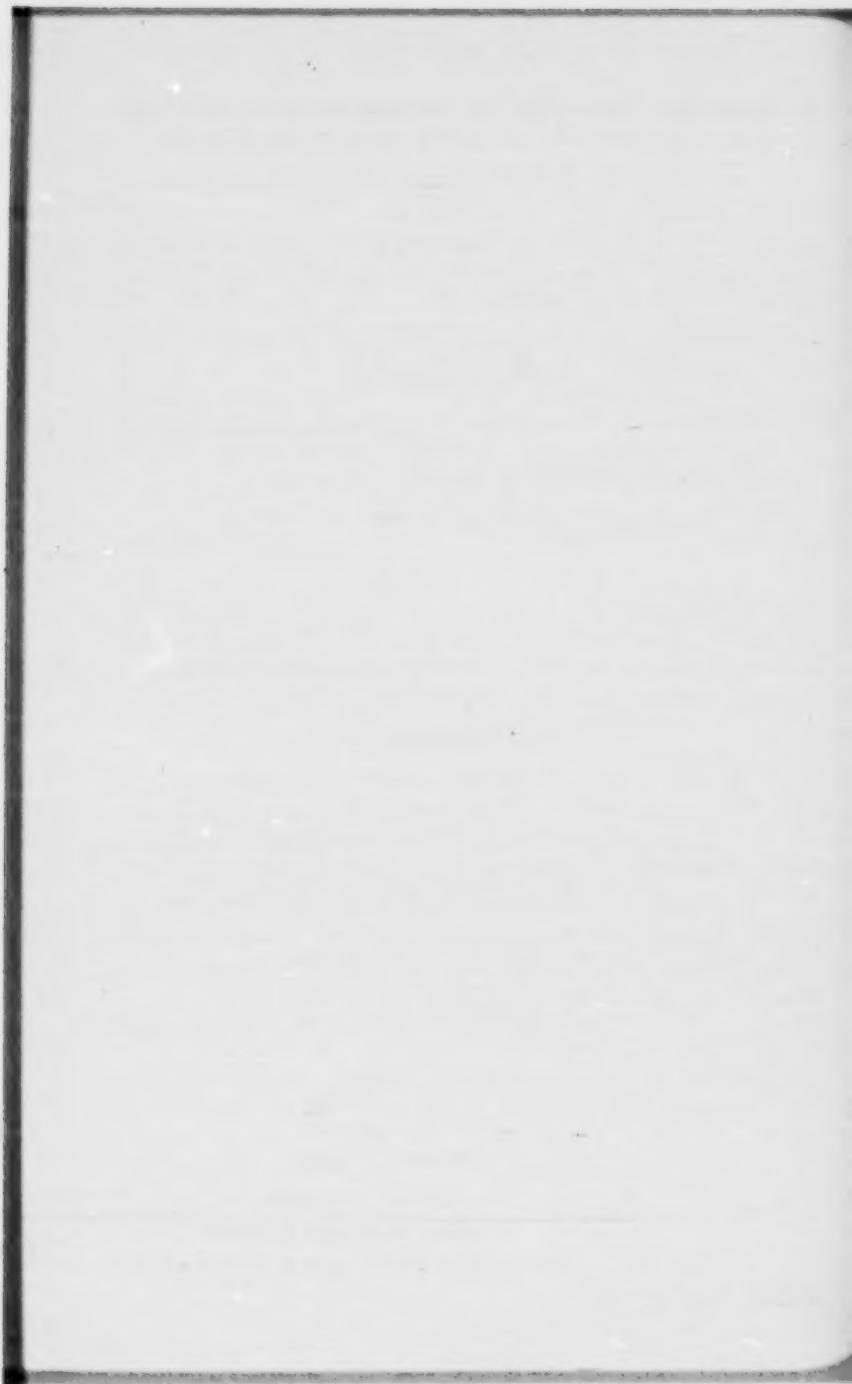
Respectfully submitted,

JOHN D. GOODLOE,
General Counsel.

W. MEADE FLETCHER,
Chief Railroad Counsel.

RECONSTRUCTION FINANCE CORPORATION.

Dated: May 28, 1946.



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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1945.

No. 1221.

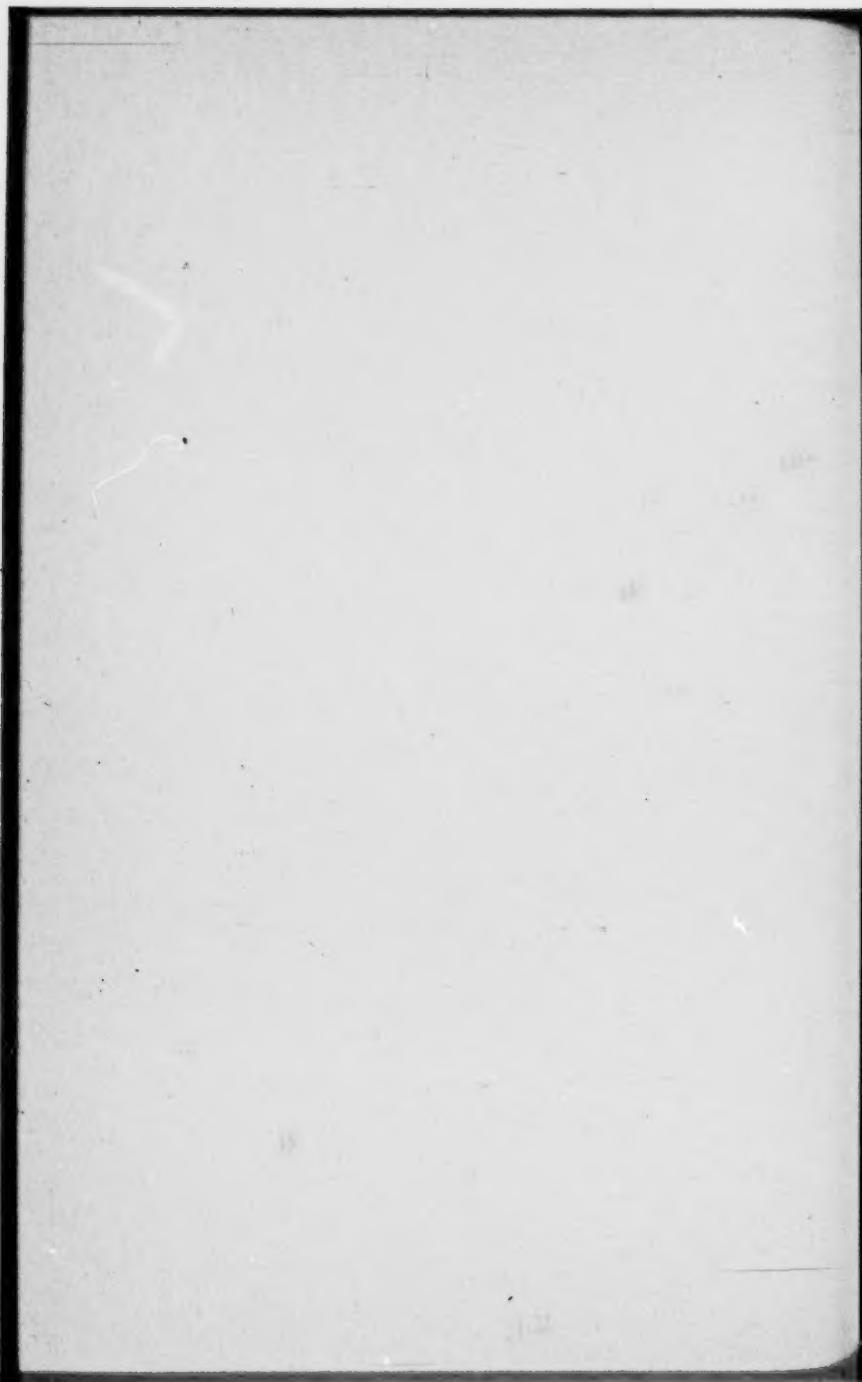
JANE CROZIER, ROBERTA GIESECKE and HARRIET
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vs.

THE BALTIMORE AND OHIO RAILROAD COMPANY.

REPLY BRIEF OF PETITIONERS CROZIER ET AL.

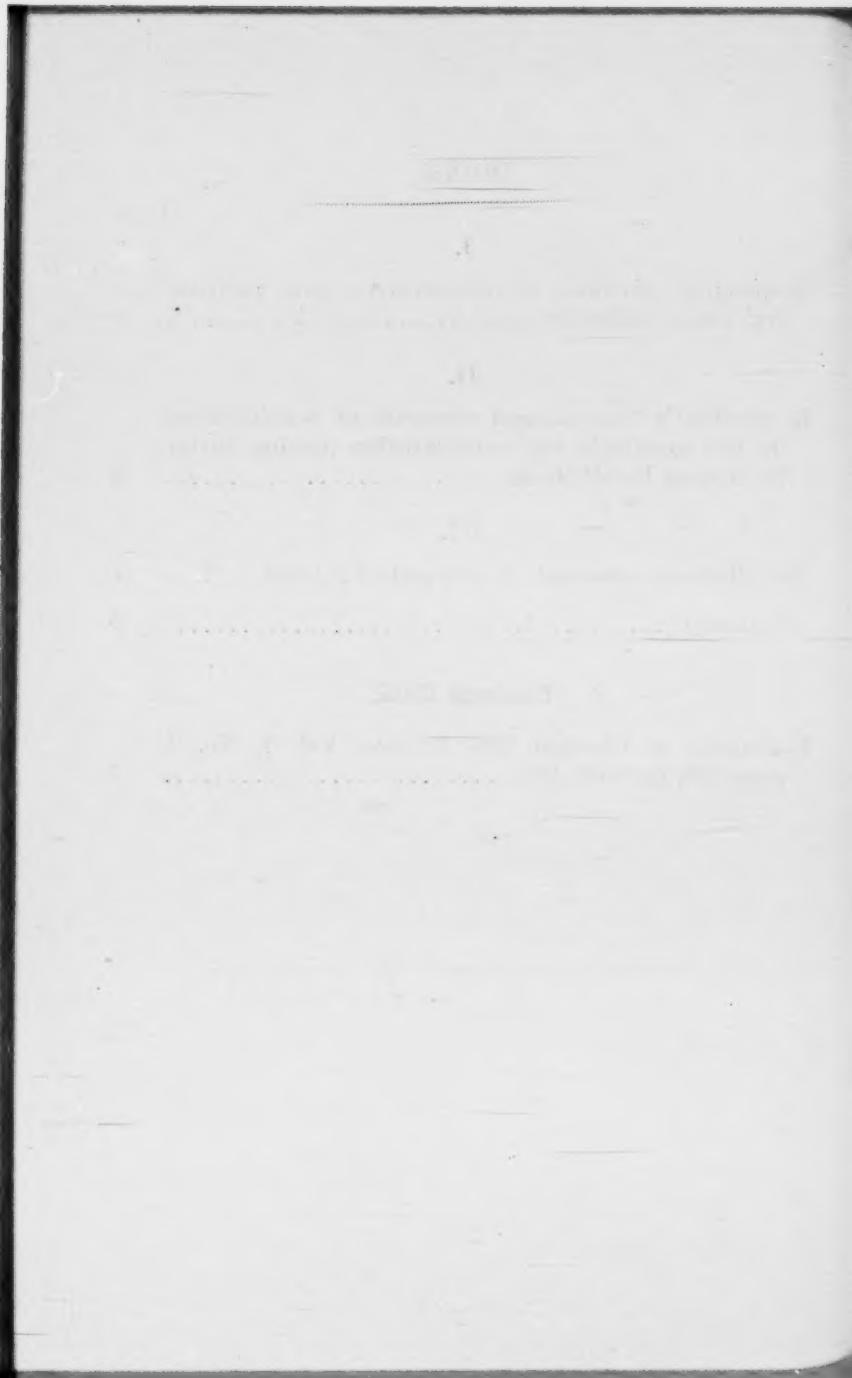
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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1945.

No. 1221.

**JANE CROZIER, ROBERTA GIESECKE and HARRIET
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Petitioners,

vs.

THE BALTIMORE AND OHIO RAILROAD COMPANY.

REPLY BRIEF OF PETITIONERS CROZIER ET AL.

REPLY BRIEF.

I.

Respondent at page 3 of its Brief attempts to state the position of these petitioners to be that there is no compensation whatsoever for the modification of the Refunding Bonds and that we suggest the modification in the mortgage securing said bonds to permit the refunding or extension of prior lien bonds is not a proper modification under Chapter XV. But that is not quite a correct statement of our position. Our position is that there is no compensation or fair consideration moving to the Re-

funding Bondholders as a class to compensate them for the separate and peculiar destruction of a vested right, peculiar to them as a class, which is wrought by the Plan. All of the issues have either principal or interest or both deferred or made contingent, but only the Refunding Bonds have vested rights **obliterated**. The vested right of the Refundings thus obliterated is the covenant against **extension or renewal** of prior lien bonds and, as we argued in our petition, this vested right is of great value and importance to the Refunding Bonds. The Respondent's statement of our position refers to "**refunding** or extension" of prior lien bonds. Whether this misreference is deliberate or not, we again reiterate that our position is not one of objection to **refunding** or any provision which makes refunding possible so long as such provision does not permit a maturity date in the refunding which is later than the extended maturity under the Plan of the bonds to be refunded. The mortgage securing our Refunding Bonds does not contain any covenant against a **refunding** of prior lien bonds; the restriction is only against "**extension or renewal**." It would appear that Respondent is trying to lead this Court into the same misapprehension of our position which the lower Court seems to have indulged.

At page 5 of Respondent's Brief it purports to list what "the Plan, in outline, as approved and confirmed by the Decree provides." There follows a list of seven features of the Plan, but conspicuous by its absence is the provision of the Plan which **obliterates** the covenant of the Refunding Mortgage against extension or renewal of prior lien bonds. One cannot help but ask why, why, why, did the lower Court so carefully avoid a reference to this destroyed right and so persistently refer only to the extension of maturities and the making of interest contingent (but cumulative), and now we find Respondent doing

precisely the same thing and not simply soft-pedalling the issue of the destroyed right but omitting it entirely in its recapitulation of the features of the Plan.

II.

Respondent's Brief concedes that the strict priority rule applies to a proceeding under Chapter XV, but endeavors to point this Court to what Respondent conceives to be three considerations moving to all bondholders and one moving to the Refundings and Convertibles.¹ These claimed four elements of consideration purported to move to the bondholders are referred to at pages 16 to 19 of Respondent's Brief. They are:

(1) That the Railroad agrees to maintain its property. Of course, as stated, they argue that some three and a half million dollars of annual net earnings must be devoted to the betterment of the property. Even if this does not contemplate mere maintenance, it certainly does not represent any more than any responsible and well managed railroad should provide both for the protection of its bondholders and its stockholders. If anyone benefits by it, the stockholders do just as much as the bondholders. Certainly it cannot be said that this is a special consideration running particularly to the Refunding Bondholders to compensate them for the particular and peculiar rights in their mortgage which are destroyed by this Plan. The mortgages themselves already require the Railroad to maintain its property for the protection of its secured creditors, and to urge that an agreement to retire its debt is a consideration is to overlook entirely the fact that the Plan itself gives Respondent a long extension of

¹ Respondent also recognizes on page 7 of its Brief that we argue the lower Court went beyond its jurisdiction in approving the provision of the Plan which annihilates the covenant against extension or renewal of prior lien bonds, but it neither denies such charge nor makes any argument that the Court did not exceed its jurisdiction in this respect. Its Brief is entirely silent on that point.

time in which to retire debts now due or about to mature. It is putting the cart before the horse.

(2) That the stockholders relinquish their right to have distributed to them as dividends the present book earned surplus of the company. Again Respondent overlooks the fact that the surplus (absent this Plan) is charged with the payment of debt already matured or about to mature and which the Railroad urges it is unable to pay. The stockholders could have no dividends from this source, nor any hope of it, unless this Plan is confirmed and those debts extended. In addition to this, the Plan forces the bondholders themselves to relinquish their right to have distributed to them, as interest or for the payment of presently matured or about to mature principal, of any part of the book surplus and limits the bondholders to net earnings available for interest and the other features contained in the allocation of earnings under the Plan. Moreover, the bondholders, unlike the stockholders, give up the right to payment out of capital assets. Dividends can never be paid out of capital, but bonds and the interest thereon can be. Surely, then, this is no real consideration moving to the bondholders, and even if it is, it moves to all of them alike and constitutes nothing special to the Refunding Bondholders to constitute fair consideration for the destruction of the covenant in their mortgage against extension or renewal. In the footnote at the bottom of page 17 the Respondent argues that if their 1944 maturities could have been extended without the conditions imposed by the holders thereof, the earnings that year could have been used to pay \$3.00 per share on Common Stock and \$4.00 per share on the Preferred Stock. This cannot help but remind us of the old remark that, "If there had been wheels on grandma, she would have been a wagon." The whole point is that the stockholders have not surrendered any right because their obligation was to pay the maturities and to pay the fixed interest,

and the Plan instead grants them more liberties and removes the present insurmountable restrictions (matured and about to mature indebtedness and fixed interest) upon the paying of any dividends. The argument indeed is one in reverse and should not mislead this Court.

(3) That the Plan provides for the cancellation of approximately \$3,600,000 of bonds of issues affected by the Plan now held in the Respondent's treasury and which but for the Plan could be reissued. In the Trial Court it was urged that the cancelled bonds would amount to \$6,350,000, and Respondent in its Brief to that Court so argued on page 29 thereof. In our Brief to that Court we pointed out that of this amount \$2,668,000 of such bonds were already held by the mortgage trustees, and it is our belief that the remaining \$3,600,000 were acquired by the company from funds created by the capital or sinking fund provisions under the 1938 Plan. It is an odd argument for a debtor to urge that he gives consideration to his creditors, particularly a new consideration moving to them, when he pays his indebtedness, and yet in the final analysis that is the argument the Railroad is here making. Furthermore the Plan gives Respondent the express new right to issue additional bonds which in reality makes this small cancellation meaningless. Once again it can not be argued that this is a consideration, if it is one, moving peculiarly to the Refunding Bondholders to compensate them for the destroyed rights.

(4) The fourth and last element of consideration claimed by the Respondent is the conversion privilege in the Convertible and Refunding Bonds. Whether extending the conversion privilege of the Convertible Bonds over the additional fifty years during which the maturity of the Convertible Bonds is extended is any consideration moving to them is a point we need not discuss, but with respect to the conversion privilege in the Refunding

Bonds, that privilege was granted to them under the 1938 Plan for a partial modification of the covenant against extension or renewal of prior lien bonds and was granted to them in that Plan for the life of those bonds. Their maturity is not extended by the present Plan. The 1944 Plan was ambiguous with respect to the conversion privilege for the new Refunding Bonds proposed to be issued to consummate the Plan. We challenged the apparent elimination of the conversion privilege by the present Plan on the ground that it had become a vested right for the duration of the bonds by virtue of the 1938 Plan, and the Respondent's counsel stated in open court that it was not the intention by the Plan to deprive Refunding Bondholders of the conversion privilege they had under the 1938 Plan. Nevertheless the lower court required a modification of the Plan to make retention of the conversion feature unmistakably clear, but such action retaining an already existing right cannot be said to create any consideration moving to the Refunding Bondholders under the Plan now before this Court.

Respondent's Brief (bottom page 19) points out that because of the Plan, so long as bondholders do not receive their current due, the stockholders can get nothing. This is true, **but it is also true without a Plan.** Respondent, however, does not point out the corollary which is that without the Plan, the stockholders could not get anything, whereas with the Plan they could declare a dividend the day after it became effective. This shows rather conclusively who gets the benefits from the Plan. Respondent's reference to recognized financial services which would rate the new bonds as better than those now outstanding disregards the fact (pointed out in our Brief below) that the same Moody Service which made the statement contained in the Respondent's Exhibit PX-98 we subsequently learned made the following statement in their Bond Survey of September 10, 1945, at page 203:

"In any event should the Plan fall through, it would not importantly change the position of bond-holders, which, in the final analysis, will hinge principally on earnings."

Perhaps the Respondent was unaware on September 17 through September 21, 1945 that the very Moody Service on which they relied had made this statement about the Plan. At any rate they only introduced into evidence Moody's much earlier publication in which that service estimated the rating of the bonds would be slightly improved if the Plan were consummated.

III.

Respondent's Brief recites (p. 5) that this is the fourth decision of a Court under Chapter XV which the Supreme Court has been requested to review on certiorari. It is true that the other three applications have been denied but, insofar as we are able to ascertain, none of the other three raised the points raised in our petition. In fact, Professor Hubert Will of the University of Chicago in an article written for the University of Chicago Law Review expressed some surprise that in the first such application to this Court for certiorari (**309 U. S. 654, 84 L. ed. 1003**), "The Petitioner's Brief surprisingly did not question the fairness of the B. & O. Plan, however, so the denial of the petition casts little light on what constitutes a 'fair' Chapter XV Plan." (**University of Chicago Law Review, Vol. 7, No. 2, page 220, Footnote 100.**)

It is a completely unsupported statement which Respondent makes (Brief, p. 11) that we endeavor "to prevent, delay or make **refunding** operations more cumbersome." We deny any such purpose and cannot help but believe that Respondent makes such charge against our petition in an effort to confuse this Court as to the precise purpose of our objection to the complete elimination

of the covenant in the Refunding Mortgage against extensions or renewals. Our objection is against a program designed to permit the company to extend maturities of prior lien bonds beyond 1980.

In the fourth and fifth lines on page 15 of its brief Respondent endeavors to create the impression that the Plan destroys no rights absolutely because, as they say, "No affected creditor's claim is scaled as to either principal or interest." The statement is true insofar as it goes, but it is not the whole truth. The Plan does more than simply "postpone" the enforcement of rights, and it is the utter annihilation by the Plan of the covenant contained in the Refunding Mortgage against renewal or extension of prior lien bonds to which we object.

Appendix A to Respondent's Brief is intended to deal only with Convertible Bonds. It was contained in the Railroad's original Brief to the lower Court as Appendix F. It is only fair to point out that of the allocation to "Sinking Fund, Paragraph (6), Article III," and "Additional Sinking Fund Payments, Article VII," the Plan permits the Board of Directors of Respondent (Article VI of the Plan) to apply one-half of such payments to working capital and/or the cost of capital investments. So long as the Board has this discretion, it is improper for the Respondent to try and lead this Court into the belief that the sums shown on those two lines of their Appendix A would all be put into the sinking fund because, in fact, a substantial part of the item marked "Total Sinking Fund Payments" can and probably will at the sole discretion of the Directors representing the stockholders be diverted from the sinking fund and put into the company's **working capital**. It is very misleading for the Respondent to have given this Appendix to the Court without explaining the effect of the provisions of Article VI of the Plan.

CONCLUSION.

It is respectfully submitted that the application of these Petitioners for a Writ of Certiorari should be granted.

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